Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1978

No. 78-309

TOUCHE ROSS & CO.,

Petitioner,

—against—

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner Touche Ross & Co. ("Touche Ross"), defendant-appellee below, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit entered herein on April 21, 1978.

OPINIONS BELOW

The opinion of the Court of Appeals (1a-35a[1]) is not yet officially reported, and is unofficially reported at [Current Binder] FED. SEC. L. REP. (CCH) ¶ 96,404. The opinion of the District Court (40a-58a) is reported at 428 F.Supp. 483.

[1]Numerals followed by the letter "a" refer to pages of the Appendix to this Petition.

JURISDICTION

The judgment of the Court of Appeals (36a-37a) was entered on April 21, 1978. The Court of Appeals denied Touche Ross' timely petition for rehearing and suggestion for rehearing *en banc* on July 7, 1978 (38a-39a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

QUESTIONS PRESENTED

1. Does Section 17(a) of the Securities Exchange Act of 1934, which requires the filing of certain reports by a securities brokerage firm, create in favor of customers of the brokerage firm an implied private right of action against accountants who audited such reports for damages resulting from misstatements therein, even though Section 18(a) thereof already expressly provides a limited private damage remedy for such misstatements, and even though the implied remedy under Section 17(a) would be broader than the limited express remedy of Section 18(a)?

2. If (as the Court of Appeals held) Section 17(a) does create such an implied right of action, is a Trustee liquidating the business of the brokerage firm pursuant to the Securities Investor Protection Act of 1970 empowered to assert such implied right of action on behalf of customers whose property he is unable to return in the course of the liquidation?

3. If (as the Court of Appeals held) Section 17(a) does create such an implied right of action, is Securities Investor Protection Corporation, upon advancing funds to the Trustee for the payment of claims of customers pursuant to the Securities Investor Protection Act of 1970, subrogated to such implied right of action of such customers, even though the Act expressly provides (in Section 6(f)(1)) only that Securities Investor Protection

Corporation is subrogated, upon the advancement of such funds, to the customers' rights against the estate of the brokerage firm, and not to the customers' rights against third-parties such as accountants?

STATUTES AND RULES INVOLVED

Sections 17(a) and 18(a) of the Securities Exchange Act of 1934 (the "1934 Act"), 15 U.S.C. §§ 78q(a), 78r(a), and Rule 17a-5 of the Securities and Exchange Commission (the "SEC"), 17 C.F.R. § 240.17a-5, and Sections 6(b)(1) and 6(f)(1) of the Securities Investor Protection Act of 1970 ("SIPA"), 15 U.S.C. §§ 78fff(b)(1), 78fff(f)(1), all as in effect in 1972, are set forth in the Appendix hereto (59a-70a).

STATEMENT OF THE CASE

The federal claims on the basis of which respondents (plaintiffs-appellants below) here seek access to the federal courts are based solely upon Section 17(a) of the 1934 Act, which is one of the various reporting provisions of the 1934 Act (see p. 12 n.7, *infra*) and requires the filing by broker-dealers of "reports" prescribed by the SEC. Consequently, since respondents concededly are unable to assert the express remedy provided in Section 18(a) of the 1934 Act for misstatements in Section 17(a) reports, this action presents, in the words of the Court of Appeals majority, the "question whether [an implied] private cause of action exists under section 17[a] . . . against accountants who prepare misleading statements of a broker's financial affairs, and if so, who may maintain such an action" (2a-3a). Over a vigorous and scholarly dissent, the Court of Appeals majority held, in the first such holding in the 44 years since enactment of Section 17(a), that it does create such an implied private right of action.

A. The Facts

This action arises from the liquidation pursuant to SIPA of the business of Weis Securities, Inc. ("Weis"), a

defunct brokerage firm, and seeks to recover for respondents from Touche Ross aggregate damages of $65,000,000 allegedly resulting from the liquidation. Respondent Edward S. Redington (the "Trustee") is the Trustee appointed pursuant to SIPA for the liquidation. Respondent Securities Investor Protection Corporation ("SIPC") advanced, in accordance with the provisions of SIPA, by which it was created and pursuant to which it acts, funds to the Trustee to pay the claims of certain customers of Weis in the liquidation. Touche Ross is a firm of certified public accountants which audited financial reports (the "1972 Weis financial reports") of Weis for periods ending May 26, 1972, approximately a year before the Weis collapse.

The Trustee and SIPC commenced this action in the United States District Court for the Southern District of New York in April 1976, nearly a year after they had commenced an almost identical action (the "State Court Action") against Touche Ross in the New York state courts. The State Court Action, which is presently pending, is based upon the same factual allegations, asserts essentially the same claims and seeks the same aggregate damages of $65,000,000 as does this federal action.[2]

[2]The State Court Action was commenced in July 1975, and is entitled *Edward S. Redington, as Trustee for the liquidation of the business of Weis Securities, Inc., and Securities Investor Protection Corporation* v. *Touche Ross & Co.* (Sup. Ct. N.Y. County, Index No. 13996/76). The only material difference in the two actions is the addition in the complaint in this action of the few allegations deemed by respondents to be necessary to assert their Section 17(a) claims—*i.e.*, the few allegations by which the Trustee and SIPC seek to "federalize" what are essentially nothing more than common law claims of accountants' negligence and malpractice. As the Court of Appeals majority put it, "[t]he common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under section 17 of the [19]34 Act were omitted. Five of the Trustee's six present 'causes of action' appear in identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims" (5a).

According to the complaint, the allegations of which are accepted for purposes of this Petition (see also 4a[n. 4]), Weis was a broker-dealer in securities registered with the SEC and a member of the New York Stock Exchange (the "Exchange"). As the result of investigations by the SEC and the Exchange in April and May 1973, and upon the application of the SEC and SIPC, the United States District Court for the Southern District of New York on May 30, 1973, ordered the liquidation of Weis pursuant to SIPA, and appointed the Trustee.

Certain officers of Weis had misstated the financial condition and results of operations of Weis in the 1972 Weis financial reports, which were required to be filed with regulatory authorities pursuant to Section 17(a) of the 1934 Act, and had made it appear therein that Weis had pre-tax earnings for the fiscal year of $1,700,000, whereas Weis actually had suffered losses in excess of $1,500,000. According to the Trustee and SIPC, Touche Ross performed its audit of the 1972 Weis financial reports in a "negligent, reckless, careless, unskilled and grossly negligent manner", and therefore not only failed to discover the misstatements but also improperly certified that the 1972 Weis financial reports fairly and accurately presented the financial condition of Weis in accordance with generally accepted accounting principles. The Trustee and SIPC also contend that if Touche Ross had discovered the misstatements in the 1972 Weis financial reports, Weis' declining financial position and the waste of its assets would have been revealed earlier, remedial action such as a change in the Weis management or merger with another firm could have been taken, the forced liquidation of Weis could have been averted or its adverse consequences reduced, and the losses here sued for would not have occurred.

On the basis of the foregoing, the Trustee seeks (either on behalf of Weis itself or for the customers of

Weis) to recover damages of $51,000,000, alleging (i) a federal claim that Touche Ross' deficient audit of the 1972 Weis financial reports violated Section 17(a) of the 1934 Act, and (ii) common law claims of accountants' negligence and malpractice, breach of contract and breach of warranty. SIPC seeks to recover (either in its own right on account of funds it advanced to the Trustee or as subrogee of the customers for whose claims it advanced such funds) damages of $14,000,000, alleging (i) federal claims of violation of Section 17(a) by Touche Ross, and (ii) common law claims of accountants' negligence and malpractice. As noted (p. 4 n.2, *supra*), the federal claims of both the Trustee and SIPC are essentially nothing more than the restatement of their common law claims—basically for accountants' negligence and malpractice—together with the additional conclusory allegations that Touche Ross' conduct also violated Section 17(a).

B. The Dismissal of This Action By The District Court

In the District Court, Touche Ross moved to dismiss this action on the grounds that (i) the federal claims of the Trustee and SIPC, which are based solely on Section 17(a) of the 1934 Act, fail to state a claim upon which relief can be granted because Section 17(a) does not create any implied private right of action, and (ii) subject matter jurisdiction of their common law claims is lacking.[3] The District Court granted the motion and

[3]The District Court had jurisdiction of the Section 17(a) claims by virtue of Section 27 of the 1934 Act. Jurisdiction of the common law claims was alleged to exist by reason of pendent jurisdiction, as well as (for the Trustee) jurisdiction under SIPA and the Bankruptcy Act and (for SIPC) diversity jurisdiction. Touche Ross' motion asserted, and the District Court held, that pendent jurisdiction was lacking because the federal claims under Section 17(a) fail to state a claim upon which relief can be granted, and that subject matter jurisdiction of the common law claims did not exist on any of the other alleged bases.

dismissed the action (40a-58a).[4]

In holding that no private right of action can be implied under Section 17(a), the District Court reasoned that, while there was no explicit statement of legislative intent with respect thereto, the grant in Section 18(a) of an express and carefully limited remedy for misstatements in Section 17(a) reports, as well as for misstatements in reports filed pursuant to other reporting provisions of the 1934 Act, only to purchasers or sellers of securities in reliance upon such misstatements, "strongly suggest[s] a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18" (49a-50a). The District Court also concluded that it is not "necessary to imply a civil liability under Section 17 in order to enforce its provisions" (51a). The District Court explicitly followed recent decisions of this Court which recognize that it would be anamolous and improper to impute to Congress an intention to permit an implied remedy under the 1934 Act which would be broader than the express statutory remedies specifically provided, and which emphasize that creation by judicial interpretation of an implied private damage remedy is proper only if it is necessary to effectuate Congress' goals. *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 734, 736 (1975); *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 25-26 (1977). The District Court also followed a decision of the Court of Appeals for the Third Circuit, *In re Penn Central Securities Litigation*, 494 F.2d 528 (3d Cir. 1974), and other district court decisions, which hold

[4]Touche Ross' motion also sought dismissal of certain of the common law claims for failure to state a claim upon which relief can be granted. Alternatively, the motion sought a stay of this action pending determination of the State Court Action. It was unnecessary for the District Court to reach, and it did not consider, those issues.

that other reporting provisions of the 1934 Act do not themselves, in view of the express remedy provided by Section 18(a) and its careful limitation by Congress to certain purchasers or sellers of securities, create any implied private rights of action.

C. The Decision Of The Court Of Appeals

A divided Court of Appeals (Lumbard and Timbers, CJJ., constituting the majority), over a vigorous and well-reasoned dissent (Mulligan, CJ.), reversed the District Court and remanded for further proceedings. The Court of Appeals majority held that customers of a brokerage firm have an implied private right of action under Section 17(a) against accountants for misstatements in audited reports filed pursuant thereto (6a-12a), although it expressly declined to set forth "the appropriate standard for accountant liability in [such] actions" (15).[5] Moreover, the majority, while recognizing that neither the Trustee on behalf of Weis nor SIPC in its own right has any right of action under Section 17(a) because they are not within any class protected thereby, also held that the Trustee, as "bailee" of certain customers' property, and SIPC, as "subrogee" of customers for the payment of whose claims it has advanced funds, may assert such right of action (12a-15a).

Judge Mulligan, in dissent, would have affirmed the order of the District Court. He concluded that there is no implied private right of action under Section 17(a) (20a-33a), and that, even if there were, the Trustee and SIPC are not proper parties to assert such right of action to recover customers' damages (33a-35a).

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[5]The majority did not disturb, and expressed no opinion as to, the District Court's holding that, absent pendent jurisdiction, there is no other basis for subject matter jurisdiction of the common law claims (3a [n.3]). The majority, even though it permitted the Trustee and SIPC to assert federal claims under Section 17(a), also expressly declined to determine whether pendent jurisdiction over the common law claims should be exercised (15a).

REASONS FOR GRANTING THE WRIT

The holding of the Court of Appeals majority that Section 17(a) provides an implied private right of action for brokerage firm customers who are not purchasers or sellers of securities, and to whom the express remedy set forth in Section 18(a) thus is not available, is erroneous and conflicts in principle with decisions of this Court and the Third Circuit. As shown hereinbelow (pp. 10-25, *infra*), that holding—which, as pointed out in Judge Mulligan's dissent, "goes beyond statutory construction; it amounts instead to judicial legislation" (27a)—(i) is based upon the majority's misapprehension of the significance of the statutory scheme which provides in the 1934 Act both a reporting requirement (Section 17(a)) and a limited *express* remedy for violations thereof (Section 18(a)), and (ii) conflicts with the principles established in this Court's decisions that, where an express remedy is provided for violation of a statute, the statute does not, in the absence of clear evidence of contrary legislative intent, give rise to another and broader implied remedy, and that under the 1934 Act specifically it is improper to imply remedies which are broader than the express statutory remedies provided therein or which are not necessary to effectuate Congress' goals, and (iii) conflicts in principle with a decision of the Third Circuit that, by reason of the express remedy in Section 18(a) for reporting violations, other reporting provisions of the 1934 Act do not themselves give rise to any implied rights of action.[6]

The majority's holding that the Trustee and SIPC may assert, as "bailee" and "subrogee", respectively, the Section 17(a) claims of certain Weis customers against Touche Ross also is erroneous. As shown hereinbelow (pp. 25-29, *infra*), that holding is based upon the

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[6]As noted by the District Court (48a), the question of whether there is an implied private right of action under Section 17(a) expressly was left undecided in this Court's decision in *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 194 n.13 (1976).

majority's misapprehension of the statutory context of the grant of powers to the Trustee, and of subrogation rights to SIPC, and conflicts in principle with decisions of this Court.

Finally, it is shown hereinbelow (pp. 29-34, *infra*) that the questions raised by the majority's decision and by this Petition are important to the administration of the federal securities laws and should be decided by this Court.

I

The Holding By The Court of Appeals Majority That, Despite The Express Remedy In Section 18(a), Section 17(a) Creates An Implied Private Right Of Action Conflicts With This Court's Decisions That, Where An Express Remedy Is Provided For Violation of A Statute, The Statute Does Not, Absent Clear Contrary Evidence Of Legislative Intent, Give Rise To Another And Broader Implied Remedy

The Court of Appeals majority bases its conclusion that a private right of action may be implied under Section 17(a) upon a purported consideration of the factors set forth in *Cort* v. *Ash*, 422 U.S. 66 (1975) (6a, 7a-11a). However, as Judge Mulligan notes in his dissent (21a, 23a), *Cort* itself carefully restricted the application of those factors to determination of "whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added), 422 U.S. at 78, a restriction which was again emphasized in *Piper* v. *Chris-Craft Industries, Inc., supra*, 430 U.S. at 37. As demonstrated in this Point I, this action does not present a situation where (as in *Cort*) a remedy is sought to be implied for violation of a statute as to which no express private remedy whatsoever is provided, but instead involves a statutory scheme in which Congress already expressly has provided both its desired statutory requirement (Section 17(a)) and the remedy (Section 18(a)) it thought necessary and appropriate for violations of that

requirement. Consequently, the controlling decisions are *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) ("*Amtrak*"), and *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975), which establish the principle that, absent clear contrary evidence of legislative intent, a remedy is not to be implied from a statutory provision for which a limited express remedy already is provided; *Blue Chip Stamps* v. *Manor Drug Stores, supra,* which recognizes the impropriety of implying broader remedies under the 1934 Act than the express statutory remedies specifically provided therein; and *Piper* v. *Chris-Craft Industries, Inc., supra,* which holds that a private right of action is not to be implied under the 1934 Act unless it is "necessary" to effectuate Congress' goals. Since there is, as even the Court of Appeals majority concedes (9a), no evidence of any Congressional intent to create an implied private right of action under Section 17(a), *Amtrak, Barbour,* and *Blue Chip Stamps* require a holding that Section 17(a) does not create any implied private right of action, and the contrary holding of the majority conflicts with those decisions. Moreover, since implication of such a private right of action is not, and was not considered by Congress to be, "necessary" to effectuate the goals of Section 17(a), *Piper* also requires a holding that there is no such implied right of action, and the contrary holding of the majority also conflicts therewith.

A. The Statutory Scheme Of The 1934 Act, Analyzed In Light Of This Court's Decisions In *Amtrak, Barbour, Blue Chip Stamps* And *Piper,* Demonstrates A Clear Congressional Intent That The Express Remedy Provided By Section 18(a) Be The Sole Remedy For Section 17(a) Violations

1. THE REPORTING REQUIREMENTS OF SECTION 17(a) AND RULE 17a-5, AND THE EXPRESS REMEDY PROVIDED IN SECTION 18(a) FOR MISLEADING REPORTS.—As this Court

recently has emphasized in cases arising under the 1934 Act, "[t]he starting point in every case involving construction of a statute is the language itself". *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 472 (1977); *Piper* v. *Chris-Craft Industries, Inc., supra*, 430 U.S. at 24; *Ernst & Ernst* v. *Hochfelder, supra*, 425 U.S. at 197; *Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 756 (Powell, J., concurring).

Section 17(a), as in effect during 1972 when Touche Ross audited the 1972 Weis financial reports, required broker-dealers such as Weis to "make such *reports* as the [SEC] by its rules and regulations may prescribe" (emphasis added). 15 U.S.C. § 78q(a).[7] SEC Rule 17a-5, implementing Section 17(a), required that broker-dealers "file reports of financial condition containing the information required by Form X-17A-5 . . . within each calendar year". 17 C.F.R. § 240.17a-5(a)(2) (1972).

Section 18 is entitled "Liability For Misleading Statements". 15 U.S.C. § 78r. Section 18(a) provides an express damage remedy for misstatements "in any . . . *report*, or document filed pursuant to [the 1934 Act] or any rule or regulation thereunder" to persons "who, in

[7]Section 17(a) is only one of the sections of the 1934 Act which require the filing of "reports" or similar material. Other such provisions are found in Sections 12(b)(1), 13(a), 13(d), 13(f) and 15(d). Section 12(b)(1) requires every "issuer" of a security "registered on a national securities exchange" to file an "application which shall contain . . . [s]uch information" as the SEC may require. 15 U.S.C. § 78l(b)(1). Section 13(a) requires every "issuer" of a registered security to file "such information and documents" and "such annual . . . and . . . quarterly reports" as the SEC may prescribe. 15 U.S.C. § 78m(a). Section 13(d) requires any person becoming the beneficial owner of more than 5% of certain classes of equity securities to file "a statement containing such . . . information" as the SEC may prescribe. 15 U.S.C. § 78m(d). Section 13 (f) requires every "institutional investment manager" to file "reports" as the SEC may prescribe. 15 U.S.C. § 78m(f). Section 15(d) requires certain issuers to file "supplementary and periodic information, documents and reports" as may be required by Section 13. 15 U.S.C. § 78o(d).

reliance upon such statement, shall have *purchased or sold* a security at a price which was affected by such statement" (emphasis added). 15 U.S.C. § 78r(a). As the Court of Appeals majority and dissent agree (11a-12a, 21a-23a), as other courts have recognized, and as the legislative history demonstrates, it is inescapable that the remedy provided by Section 18(a), which uses the very same word, "report", as does Section 17(a), is applicable to misstatements in Section 17(a) reports.

2. THE TRUSTEE AND SIPC CAN ASSERT NO CLAIM FOR RELIEF UNDER SECTION 18(a).—Both the Court of Appeals and the District Court recognize (11a, 49a), and the Trustee and SIPC concede, that neither they nor Weis' customers can meet the purchaser-seller requirement of Section 18(a), and that they thus cannot assert any claim for the express Section 18(a) remedy. Consequently, in order to find some purported basis in the 1934 Act to "federalize" their essentially common law claims for accountants' negligence and malpractice, they assert alleged implied rights of action under Section 17(a) itself.

3. THE STATUTORY SCHEME WHEREBY SECTION 18(a) PROVIDES AN EXPRESS AND LIMITED DAMAGE REMEDY FOR MISSTATEMENTS IN SECTION 17(a) REPORTS REFLECTS A CONGRESSIONAL INTENTION THAT SUCH REMEDY BE EXCLUSIVE AND THAT NO ADDITIONAL REMEDY BE IMPLIED FROM SECTION 17(a) ITSELF.—The express, and carefully limited, damage remedy provided by Section 18(a) for misstatements in Section 17(a) reports necessarily reflects a Congressional intention that a damage remedy for such misstatements would be available only as provided in Section 18(a)—*i.e.*, where a person purchased or sold a security in reliance thereon—and that no other damage remedy for such misstatements (*e.g.*, a damage remedy for brokerage firm customers who neither purchased nor sold securities in reliance

thereon) was intended or could be implied. As Judge Mulligan's dissent observes, "[the District Court] correctly found and, indeed, *common sense would dictate,* that section 18(a) expressly provides *the sole private remedy which Congress intended* to be available for a violation of section 17(a) and the other reporting sections of the [19]34 Act" (emphasis added) (22a).

4. THIS COURT'S DECISIONS IN AMTRAK, BARBOUR AND BLUE CHIP STAMPS COMPEL THE CONCLUSION THAT SECTION 18(a) PROVIDES THE EXCLUSIVE DAMAGE REMEDY FOR VIOLATIONS OF SECTION 17(a).—As Judge Mulligan's dissent correctly observes (24a-25a), the conclusion that Congress intended Section 18(a) to be the exclusive damage remedy for Section 17(a) violations accords with—indeed, is required by—decisions of this Court explicitly directing that, where a remedy is sought to be implied from a statutory provision for which a limited express remedy already is provided, the doctrine *expressio unius est exclusio alterius* is to be applied. For example, this Court's decision in *Amtrak, supra,* unequivocally directs that

> "[W]hen legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies. 'When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode.' . . . This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.* Since the Act creates . . . a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created . . . are the exclusive means to enforce the duties and obligations imposed by the Act". 414 U.S. at 458.

See also *Securities Investor Protection Corp.* v. *Barbour, supra,* 421 U.S. at 419 (reiterating the "observation [in *Amtrak*] that express statutory provision for one form of proceeding ordinarily implies that no other means of enforcement was intended by the Legislature").

While this Court did state in *Amtrak* that the *expressio unius* doctrine must "yield to clear contrary evidence of legislative intent", 414 U.S. at 458, even the Court of Appeals majority here concedes that nothing in the language or legislative history of the 1934 Act indicates any Congressional intent to create a private right of action under Section 17(a) (9a). Consequently, *Amtrak* and *Barbour* require the conclusion that, in light of the existence of the express remedy in Section 18(a), Section 17(a) does not create any additional implied remedy. The contrary conclusion of the Court of Appeals majority thus conflicts with *Amtrak* and *Barbour.*

Moreover, to hold, as does the Court of Appeals majority, that Section 17(a) creates an implied right of action in addition to the express remedy of Section 18(a) also conflicts with the principles established by this Court in *Blue Chip Stamps* v. *Manor Drug Stores, supra.* There, in upholding the purchaser-seller requirement for claims under Section 10(b) of the 1934 Act and Rule 10b-5, this Court noted that "[t]he principal express nonderivative private civil remedies, created by Congress contemporaneously with the passage of § 10(b), for violations of various provisions of the 1933 and 1934 Acts are by their terms expressly limited to purchasers or sellers of securities", and then, specifically addressing itself to Section 18(a) of the 1934 Act, stated that

> "Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to

> 'any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . .' *It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action*" (emphasis added). 421 U.S. at 735-736.

Of course, as Judge Mulligan's dissent notes, the "anomalous" intention which *Blue Chip Stamps* said could not properly be imputed to Congress "is precisely what the majority is imputing to Congress in this case" by its holding that there is an implied right of action under Section 17(a) broader than (*i.e.*, in favor of brokerage firm customers who do not meet the purchaser-seller requirement of) the express remedy under Section 18(a) (26a).[8]

As aptly summed up by Judge Mulligan's dissent,

> "*Amtrak, Barbour* and *Blue Chip* compel the conclusion that the omission [of a remedy for Section 17(a) violations in favor of brokerage firm customers] was studied and that the implication of a damage action against accountants under this section is totally unwarranted. The majority cannot properly characterize this as a case where there is no explicit private remedy provided by Congress. Rather, it is a case in which the remedy

[8]This Court also observed in *Blue Chip Stamps* that "[w]hen Congress wished to provide a remedy to those who neither purchase nor sell securities, it had little trouble in doing so expressly", citing Section 16(b) of the 1934 Act, 15 U.S.C. § 78p(b). 421 U.S. at 734. This reinforces the conclusion that the limitation to purchasers and sellers of the express Section 18(a) remedy provided by Congress for Section 17(a) violations, and the failure by Congress to provide an express remedy for Section 17(a) violations in favor of brokerage firm customers who are not purchasers or sellers, demonstrate a Congressional intention and understanding that such brokerage firm customers are to have no right of action, either express or implied, for violations of Section 17(a) (see 25a-26a).

> provided was designed to exclude the class which is here seeking monetary relief." (26a-27a)

5. PIPER BARS IMPLICATION OF A PRIVATE DAMAGE REMEDY UNDER SECTION 17(a).—In *Piper* v. *Chris-Craft Industries, Inc., supra,* this Court emphasized that under the 1934 Act a private right of action is to be implied only where it is "necessary to effectuate Congress' goals". 430 U.S. at 26. *Accord, Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 477. As shown in Judge Mulligan's dissent, analysis of the scheme by which brokerage firms are regulated demonstrates that, in seeking to protect brokerage firm customers, "the primary congressional intent obviously has been to provide a system of reports and monitoring which would *prevent* insolvency of broker-dealers[,] not to create private law suits for damages *after* insolvency has occurred", and therefore that "the importance to this scheme of implying a damage remedy *after* liquidation is dubious" (30a). To enforce compliance with the reporting requirements of Section 17(a), private damage actions thereunder in favor of persons not entitled to the remedy of Section 18(a) are not *necessary*; as the District Court here concluded, "criminal prosecutions and SEC injunctive actions seem abundantly sufficient" (53a) (see also p. 19 n.9, *infra*). As *Piper* explicitly makes clear, an "ever-present threat of damages" is not *necessary, because* "[t]he deterrent value, if any" of a private right of action is so speculative that it does not "provide significant additional protection". 430 U.S. 39-40.

B. The Court Of Appeals Majority Misapprehends The Statutory Scheme, And Fails To Apply The Analysis Required By, And Therefore Reaches A Result In Conflict With, This Court's Decisions

The Court of Appeals majority misapprehends the foregoing statutory scheme and fails to follow the controlling decisions of this Court. The following basic

errors are committed by the majority and, as Judge Mulligan's dissent demonstrates, leads the majority to a decision which conflicts with this Court's decisions.

1. THE COURT OF APPEALS MAJORITY ERRS IN FAILING TO APPLY THE ANALYSIS REQUIRED BY AMTRAK, BARBOUR AND BLUE CHIP STAMPS.—In holding that Section 17(a) creates an implied private right of action, the Court of Appeals majority plainly misapprehends the statutory scheme of the 1934 Act. Its basic error is its failure to apply the analysis required by *Amtrak*, *Barbour* and *Blue Chip Stamps* to this case, where there already exists an express remedy (Section 18(a)) for violations of the statutory provision (Section 17(a)) under which an implied remedy is sought. That analysis requires the Court of Appeals first to recognize the existence of the express remedy of Section 18(a), then to consider Sections 17(a) and 18(a) in light of the *expressio unius* doctrine, and finally to apply the doctrine to bar an implied remedy under Section 17(a) in the conceded absence of "clear contrary evidence of legislative intent". However, the majority instead purports first to analyze Section 17(a), and to determine whether it creates an implied remedy, *without any consideration of Section 18(a)* (6a-11a). Only after concluding that there is such an implied remedy does the majority finally give cursory consideration to Section 18(a), and then only to assert that it does not detract from the existence of such a remedy (11a-12a). Of course, as *Amtrak*, *Barbour* and *Blue Chip Stamps* make clear, that approach is based upon the patently erroneous view that Section 18(a) is in no way indicative of the Congressional intent as to whether Section 17(a) creates an implied remedy—a view which the majority acknowledges holding by its statement that "[w]e find no indication . . . *in the statute itself* . . . of any congressional intent either to create a private remedy under Section 17 or to deny one" (emphasis added) (9a).

2. THE COURT OF APPEALS MAJORITY ERRS IN FINDING SECTION 18(a) IRRELEVANT.—The Court of Appeals majority finds that Section 18(a) is irrelevant because brokerage firm customers are "members of a class peculiarly protected by Section 17" and "are favored wards of Section 17", that the express remedy of Section 18(a) will normally not be available to such customers, and therefore that "[w]e cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection" (11a).[9] However, the majority's conclusion simply does not follow from its premises. Even if it be assumed that Section 17(a) was specifically intended to protect brokerage customers, whereas Section 18(a) "wholly independent[ly]" was intended to provide rights only to purchasers and sellers (see 12a), the existence of Section 18(a) necessarily demonstrates a further Congressional intent that the purchasers and sellers referred to therein be the only class with a damage remedy for misstatements in Section

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[9]The Court of Appeals majority clearly overstates the issue when it says that customers will be "deprived . . . of the means of protection" without an implied right of action under Section 17(a). As Judge Mulligan's dissent spells out in detail, brokerage customers have many "protections", including the preventive monitoring of brokerage firms by the SEC and the Exchange, the existence of SIPC (after 1970), the deterrent effect of criminal and injunctive proceedings, and the availability of state law remedies. *Cf. Iroquois Industries, Inc.* v. *Syracuse China Corp.*, 417 F.2d 963, 969 (2d Cir. 1969), *cert. denied*, 399 U.S. 909 (1970) ("That the conduct averred in any given case may be reprehensible does not mean that a federal remedy must be furnished by judges. The remedy in many cases may be found in the state courts . . . . If there is to be a federal remedy, it is the Congress which must create it"), *cited with approval in Blue Chip Stamps* v. *Manor Drug Stores, supra*, 421 U.S. at 738-739 n.9. Thus, the real issue here is not whether to grant the customers a Section 17(a) implied remedy or else to leave them without any protection, but rather whether to add to the protections they already have the additional protection of a Section 17(a) implied remedy which Congress itself intentionally refused to provide.

17(a) reports. If, in enacting the 1934 Act, Congress was as aware of, and consciously concerned with protecting, both brokerage firm customers (its "favored wards" in Section 17(a), according to the majority) and purchasers and sellers (to whom it provided the express damage remedy in Section 18(a)), the withholding of an express damage remedy from the customers, while at the same time giving such a remedy to the purchasers and sellers, can only mean that Congress consciously intended that the customers not have a damage remedy and that their protection be provided in a different way. As Judge Mulligan's dissent correctly puts it,

> "if the brokers' customers were so clearly the concern of the Congress when it enacted section 17(a), its failure to afford them a private damage remedy in section 18(a), which was contemporaneously enacted and which provides a private remedy for misleading statements in reports filed pursuant to the mandate of the Act, leads to the conclusion that Congress did not intend a private damage remedy to be available to brokers' customers" (23a).

3. THE COURT OF APPEALS MAJORITY ERRS IN ITS APPLICATION OF THE PRINCIPLES OF CORT V. ASH.—As noted above (pp. 10-11, *supra*), the factors set forth in *Cort* v. *Ash*, *supra*, upon which the Court of Appeals majority relies to imply a private right of action under Section 17(a) (7a-11a), do not provide an appropriate analytical framework here because *Cort* itself limits its own relevance to "determining whether a private remedy is implicit in a statute *not expressly providing one*" (emphasis added). 422 U.S. at 78. However, even if the *Cort* factors are assumed to be relevant, the majority's analysis in terms of those factors is unacceptable because, among other things, it does not at any point

consider the significance of Section 18(a), which clearly bears on all four of the *Cort* factors.[10]

4. THE COURT OF APPEALS MAJORITY ERRS IN FAILING TO APPLY THE NECESSITY STANDARD OF PIPER.—The purported *Cort* analysis of the Court of Appeals majority also is fatally flawed by the majority's failure to apply the requirement articulated in *Piper* v. *Chris-Craft Industries, Inc.*, *supra*, that a private remedy is to be implied only where it is "*necessary* to effectuate Congress' goals" (emphasis added). 430 U.S. at 26. Application of that requirement bars implication of a private right of action under Section 17(a) (see p. 17, *supra*); and none of the reasons advanced by the Court of Appeals majority to support implication of such a right satisfies the requirement. For example, the majority's conclusion, purportedly premised upon *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964), that "a private remedy is an essential supplement to the scheme of enforcement of section 17" because the SEC "does not have the resources to examine and audit all the documents that it receives"

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[10]First, Section 18(a) shows that insofar as substantive rights and remedies may be derived from reporting obligations imposed by the 1934 Act, only purchasers and sellers, and not customers, are *the class for whose special benefit such rights and remedies are provided.* Second, it shows *a Congressional intent* to limit a damage remedy to purchasers and sellers. Third, it shows that a Section 17(a) implied right would be *inconsistent with the legislative scheme* since it effectively would abolish the limitations placed on express civil remedies. Finally, it shows a Congressional understanding that any cause of action by customers for damages is *one traditionally relegated to state law*, which, under "well established tort law principles" discussed in Judge Mulligan's dissent (30a-32a), provides appropriate remedies—remedies which are being pursued as against Touche Ross not only by the Trustee and SIPC in the State Court Action, but also as noted hereinbelow (p. 33 n.19, *infra*), by Weis' customers themselves.

(10a-11a),[11] simply is unacceptable in light of this Court's recognition in *Piper* that "[e]ven though the SEC operates in this context under the same practical restraints recognized by the Court in *Borak*, institutional limitations alone do not lead to the conclusion that any party interested . . . should have a cause of action for damages". 430 U.S. at 41.[12] Similarly unacceptable is the majority's reliance upon an asserted need for nationally uniform standards for actions brought to recover losses after a brokerage firm has failed (11a). Since the *primary* legislative purpose in enacting Section 17(a) was to provide a system of reports and monitoring to *prevent* insolvency (see p. 17, *supra*), it is not *necessary* in order to achieve that purpose that such standards for recovery of losses resulting from liquidation be uniform. This Court recently has restated the principle that where state law remedies traditionally have been available federal courts should be reluctant to intrude federal remedies into the area to serve " 'at best a subsidiary purpose' of the federal legislation", *Santa Fe Industries, Inc.* v. *Green, supra,* 430 U.S. at 478, and has recognized that relegation of plaintiffs to such state law remedies is appropriate, *e.g., Santa Fe Industries, Inc.* v. *Green, supra, id.* at 478 (state law appraisal remedy); *Piper* v. *Chris-Craft Industries, Inc., supra,* 430 U.S. at 40-41 (common law tort remedy).

[11]As noted in the opinions of the Court of Appeals majority and the District Court, the SEC, pursuant to Section 17(a), has its own program of conducting audit examinations of the financial reports of brokerage firms (10a [n.12], 48a, 53a).

[12]As the District Court here stated, "the case at bar is not like *Borak*. The reports required by Section 17 in 1972 were not for the information of any 'investors' and were not sent to them but were for the SEC, primarily for monitoring the net capital requirements of the 1934 Act" (53a). Moreover, as Judge Mulligan's dissent points out, the problem faced by the SEC in *Borak* of examining proxy statements under demanding time limitations is not encountered with respect to its examination of Section 17(a) reports, and the SEC's burden also is lightened by examinations which are performed by the Exchange (32a [n.11]). As the dissent also notes, the rationale of *Borak* has been significantly restricted by more recent decisions of this Court (20a-21a).

II

The Holding By The Court Of Appeals Majority That, Despite The Express Remedy In Section 18(a), Section 17(a) Creates An Implied Private Right Of Action Conflicts With A Decision Of The Third Circuit, And Numerous District Court Decisions, Which Hold That No Rights Of Action May Be Implied Under Other Reporting Provisions Of The 1934 Act

The holding of the Court of Appeals majority that a private right of action may be implied under Section 17(a) conflicts in principle with the decision of the Third Circuit in *In re Penn Central Securities Litigation, supra,* as well as a substantial number of district court decisions, involving other reporting provisions of the 1934 Act. Those decisions all hold—for reasons equally applicable to the reporting provisions of Section 17(a)—that no private rights of action can be implied from the reporting provisions themselves, because Section 18(a) is the exclusive remedy for reporting violations, and because the creation of additional implied remedies from the reporting provisions themselves would ignore the Congressional intent and this Court's controlling decisions and distort the statutory scheme.

In re Penn Central Securities Litigation, supra, involved actions arising out of the operations of the Penn Central companies in which plaintiffs alleged that reports filed under Section 13(a) were misleading and asserted (because they were not purchasers or sellers of securities and thus did not fall within Section 18(a)) that they had an implied right of action for damages under Section 13(a) itself. The District Court dismissed the Section 13(a) claims, 347 F.Supp. 1327 (E.D.Pa. 1972), *decision as to Section 13(a) adhered to on reargument,* 357 F.Supp. 869 (E.D.Pa. 1973), emphasizing that

> "Section 13 is one of a number of provisions [of the 1934 Act] that require the filing of . . .

> reports. *See* §§. . . 17(a). Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the [1934] Act", 347 F.Supp. at 1340,

and then, although recognizing that "Courts have implied civil remedies for violations of [certain] provisions of the [1934 Act]", held that Section 18(a) "is the exclusive remedy for violation of § 13(a)" because

> "when the legislature has specifically authorized or withheld the right to recover damages arising by reason of a violation of a statute, an implied right of action does not exist. . . . Where Congress has specifically authorized a remedy for violation of an act, the courts should not nullify the congressional scheme by implying a right of action on behalf of those not otherwise entitled to recover. . . . Given the express civil remedy for § 13(a) provided by § 18(a), we conclude that § 13(a) does not afford a private right of action", 347 F. Supp. at 1339-1340.

The Third Circuit affirmed. 494 F.2d 528 (3d Cir. 1974). It emphasized that a contrary holding "would result in the elimination of the purchaser-seller requirement for violations of § 13(a)", and that "the same considerations [which require application of the purchaser-seller requirement to section 10(b)] also apply to [require denial of] the contention . . . that we should imply a private right of action in section 13(a) to avoid the purchaser-seller requirement of section 18." *Id.* at 540-541.[13]

[13]Numerous district court decisions have reached the same result as did the Third Circuit in *In re Penn Central Securities Litigation.* See, *e.g., Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F.Supp. 213 (S.D.N.Y. 1975), *aff'd by oral opinion*, 538 F.2d 312 (2d Cir. 1976) (Section 13(d)); *Cramer* v. *General Telephone & Electronics*, [1978] FED. SEC. L. REP. (CCH) ¶ 96,380 at pp. 93,326-93,327 (E.D. Pa. 1977) (Section 12(b)(1)); *DeWitt* v. *American Stock Transfer Co.*, 433 F.Supp. 994, 1004-1005 (S.D.N.Y.) (Sections 13(a) and 15(d)), *modified on other grounds*, 440 F.Supp. 1084 (S.D.N.Y. 1977); *Levy* v. *Johnson*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,899 at p. 91,324 (S.D.N.Y. 1977) (Section 13(a)); *Lewis* v. *Elam*, [1977-78 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 96,013 (S.D.N.Y. 1977) (Section 13(a)); *Meer* v. *United Brands Co.*, [1976-77 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 95,648 (S.D.N.Y. 1976) (Section 13(a)); *In re Equity Funding Corp. of America Securities Litigation*, 416 F.Supp. 161, 190 (C.D. Cal. 1976) (Section 13(a)); *McLaughlin* v. *Campbell*, 410 F.Supp. 1321, 1325 (D.Mass. 1976) (Section 13(a)); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D.Del. 1973) (Section 13(a)).

The reasoning and holding of *In re Penn Central Securities Litigation*, and of the other decisions reaching the same result, are clearly applicable to Section 17(a). Section 17(a), like the sections of the 1934 Act involved in those decisions, is a reporting provision, and Section 18(a) is as applicable to misleading reports filed under Section 17(a) as it is to such reports filed under those other sections.

Thus, the decision of the Court of Appeals majority creates a conflict between the Second Circuit and the Third Circuit concerning whether private rights of action may be implied under the reporting provisions of the 1934 Act, and this Court should grant certiorari to resolve that conflict.

III

The Holding Of The Court Of Appeals Majority That The Trustee And SIPC Are Appropriate Parties To Seek Recovery Of Customers' Damages Is Erroneous And Conflicts With Applicable Decisions Of This Court

Both the Court of Appeals majority and Judge Mulligan in dissent agree that, even if Section 17(a) creates an implied right of action for brokerage firm customers, neither the Trustee on behalf of Weis nor

SIPC in its own right is entitled to assert any right of action under Section 17(a), because neither is a member of any class protected thereby (12a [n. 13], 14a, 33a-34a). However, misapprehending the controlling decisions of this Court, the majority, again over Judge Mulligan's vigorous dissent, erroneously holds that the Trustee as "bailee" and SIPC as "subrogee" are appropriate parties to assert the Section 17(a) rights of certain *customers* of Weis (12a-13a).

A. The Holding With Respect To The Trustee Is Erroneous And Conflicts With This Court's Decision In *Caplin* v. *Marine Midland Grace Trust Co.*

Contending that Touche Ross' Section 17(a) violations caused the depletion of property held by Weis in trust for its customers, the Trustee seeks to assert the customers' damage claims, on the ground that Weis was the bailee of their property and thus had a sufficient interest therein to sue third parties for loss or injury thereto. However, any action by Weis itself (or by the Trustee as its representative) as bailee of customers' property would be an action to vindicate Weis' own possessory rights as bailee, and not the rights of the customers, *see generally* W. PROSSER, LAW OF TORTS 94-95 (4th ed. 1971); O. HOLMES, THE COMMON LAW 130-194 (1963 ed.), and even the Court of Appeals majority concedes that Weis itself, and the Trustee on behalf of Weis, have no right of action under Section 17(a) (14a). Nevertheless, the majority does find, in the Trustee's statutory duty to marshal and return customers' property, authorization for the Trustee to sue on behalf of customers whose property he is unable to return, to the extent that they have not been reimbursed by SIPC (13a-15a).

That holding of the Court of Appeals majority is erroneous because under Section 6(b)(1) of SIPA, 15

U.S.C. § 78fff(b)(1), the Trustee has the same title to property and powers as a bankruptcy or Chapter X trustee. *Caplin* v. *Marine Midland Grace Trust Co.*, 406 U.S. 416 (1972), establishes the principle that such a trustee, and therefore the Trustee here, is not a proper party to assert claims of customers. In *Caplin*, this Court held that the Chapter X trustee of a corporation has no standing to assert claims on behalf of any particular class of creditors (there, holders of its debentures) against third parties, because

> "[i] nowhere in the statutory scheme is there any suggestion that the trustee . . . is to assume the responsibility of suing third parties on behalf of debenture holders . . . . [ii] [the corporation] could [not] make any claim . . . [and thus] any suit by debenture holders would not affect the interests of other parties to the reorganization . . . [iii] a suit by him on behalf of debenture holders may be inconsistent with any independent actions that they might bring themselves." 406 U.S. at 428-432.

Caplin compels the conclusion here that the Trustee may not sue on behalf of any particular class of creditors of Weis, including the class specified by the Court of Appeals majority, *viz.*, those Weis customers whose claims against Weis for their property have not been satisfied. In the first place, as in *Caplin*, there is no statutory authorization for any such suit. Second, any recovery by the Trustee would be on behalf of the customers only and would be of no benefit to other general creditors, since, as in *Caplin*, payment by Touche Ross of customers' claims simply would subrogate Touche Ross to the customers' claims against the Weis general estate. Third, there would be a proliferation of litigation since Weis' customers can sue—indeed, already have sued (see pp. 31, 33 n.19, *infra*)—Touche Ross; the

Trustee may be unable to bind the customers to any settlement; and the Trustee would be inappropriate as the customers' class representative, since he has no common interest with them and may have conflicting interests, in view of his obligations to general creditors and others.[14]

B. The Holding With Respect To SIPC Is Erroneous And Conflicts With This Court's Decisions In *Amtrak* And *Barbour*

SIPC is created by, and its powers are specified in, SIPA, which establishes a comprehensive statutory scheme for brokerage firm liquidations. Section 6(f)(1) of SIPA sets forth the subrogation rights of SIPC, as follows:

> "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be *subrogated to the claims of such customers with the rights and priorities provided in this section*" (emphasis added). 15 U.S.C. § 78fff(f)(1).

Both the Court of Appeals majority and Judge Mulligan in dissent hold that under Section 6(f)(1) SIPC, upon advancing funds to pay "claims" of customers, is subrogated *only* to the "claims" of such customers *against the Weis estate* (12a-13a, 34a).

In light of the comprehensive statutory scheme of SIPA, Congress clearly intended that SIPC's express statutory subrogation to customer "claims" against the

[14] In failing to recognize that such proliferation of litigation also is *unnecessary*, the Court of Appeals ignored the teaching of its own earlier decision in *Lank* v. *New York Stock Exchange*, 548 F.2d 61, 67 (2d Cir. 1977), which held it impermissible for a receiver of a brokerage firm to sue where the brokerage firm could not, even though any recovery would be for the benefit of public investors, because "those investors already have a cause of action in their own right . . . and the receiver's suit would add nothing to their rights."

brokerage firm's estate be SIPC's exclusive subrogation remedy, and that SIPC's subrogation rights not extend to the claims of customers against third parties. See, *e.g.*, *Amtrak, supra,* 414 U.S. at 458 ("when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies"); *Securities Investor Protection Corp.* v. *Barbour, supra; Rogers* v. *National Surety Co.*, 116 Neb. 170, 216 N.W. 182 (1927) (under statute establishing a "depositor's guaranty fund", express provision subrogating such fund to the rights of creditors paid by the fund to participate in the defunct bank's assets held, under *expressio unius* principle, to be the fund's exclusive subrogation remedy).

Nevertheless, the Court of Appeals majority, again over Judge Mulligan's vigorous dissent which emphasizes that SIPC is "a congressionally created corporation with limited powers to litigate" (34a), erroneously holds that SIPC has subrogation rights beyond those expressly provided to it in Section 6(f)(1), and is thereby subrogated also to the alleged Section 17(a) claims of the customers against Touche Ross. In so holding, the Court of Appeals majority is in conflict with this Court's decisions requiring application of the *expressio unius* doctrine and circumvents the intent of Congress as expressed in SIPA itself.

IV

The Questions Raised By This Petition Are Important To The Administration of the Federal Securities Laws And Should Be Decided By This Court

A. The Question of Whether Section 17(a) Creates Any Implied Right Of Action Should Be Decided By This Court

The holding of the Court of Appeals majority that Section 17(a) creates an implied private right of action for brokerage firm customers who are not purchasers or

sellers of securities as required by Section 18(a) should be reviewed by this Court. That holding is not only erroneous, and in conflict with this Court's controlling decisions in *Amtrak, Barbour, Blue Chip Stamps* and *Piper* and with the Third Circuit's decision in *In re Penn Central Securities Litigation,* but also raises questions which are important to the administration of the federal securities laws, for the following reasons.

1. The majority's recognition of a new implied right of action under Section 17(a)—a right of action not heretofore perceived by any other court or litigant in the 44 years since enactment of the 1934 Act—has the serious potential for greatly expanding the volume of litigation under the 1934 Act in, and thereby further burdening, the federal courts. All customers of failed or failing brokerage firms now have, under the majority holding, a potential Section 17(a) right of action against third parties allegedly responsible for misstatements in Section 17(a) reports. The resulting likelihood of proliferating litigation is seen from the facts that (i) between 1970 and 1977, 128 brokerage firms have failed and been placed in SIPA liquidation, (ii) such failures, seven of which occurred in the last year alone, continue to be a fact of life in today's mercurial and often troubled securities markets, and (iii) the total number of customers of such failed brokerage firms is huge, with more than 104,000 customer claims already having been satisfied in whole or in part in SIPA liquidations as of December 31, 1977.[15] That the prospect for a greatly-expanded volume of 1934 Act litigation is real, and not simply speculative, is demonstrated by the fact that on April 27, 1978, only six days after the decision of the Court of Appeals here, customers of Weis commenced in the United States District Court for the Southern District

[15]SIPC SEVENTH ANNUAL REPORT (1977) 5-6, 28.

of New York a class action against Touche Ross asserting implied rights of action under, and seeking damages for alleged violations of, Section 17(a). *Rosen* v. *Touche Ross & Co.* (S.D.N.Y. 78 Civ. 1943).[16] Moreover, the satisfaction of customer claims in brokerage firm liquidations does not remove—indeed, appears even to increase—the potential for 1934 Act litigation, in light of the majority's holding that SIPC, to the extent that it advances funds for payment of such claims, is subrogated to and may assert customers' Section 17(a) rights against third parties. As of December 31, 1977, SIPC had advanced almost $54,000,000 for payment of customers' claims (*i.e.*, almost $40,000,000 in excess of the $14,000,000 advanced for payment of such claims in the Weis liquidation)[17]—advances so substantial as to demonstrate a likelihood that SIPC will find itself compelled to assert such Section 17(a) claims.

Of course, the potential for greatly-increased 1934 Act litigation is not limited to situations where the brokerage firm involved is in liquidation. Under the holding of the Court of Appeals majority, Section 17(a) claims can be asserted by customers with respect to the Section 17(a) reports of any of the over 5,000 brokers and dealers registered with the SEC.

Finally, since Section 17(a) is a reporting provision, the majority's holding is authority for implying rights of action under all of the other reporting provisions of the 1934 Act in favor of persons who are not purchasers or

[16]Since *Rosen* v. *Touche Ross & Co.* was commenced after, and as the direct consequence of, the Court of Appeals decision, reference thereto necessarily does not appear in the record on which the decision was based. However, this Court may (and hereby is requested to) take judicial notice thereof. See, *e.g., Massachusetts* v. *Westcott,* 431 U.S. 322, 323 n.2 (1977).

[17]SIPC SEVENTH ANNUAL REPORT (1977) 6, 28-29.

sellers and who therefore may not assert the express remedy provided in Section 18(a). Numerous plaintiffs already have sought to assert such implied rights in the actions, including *In re Penn Central Securities Litigation*, already cited herein (pp. 23-25, *supra*); and, although the efforts of such plaintiffs heretofore have been unsuccessful, the majority's holding here only can give new impetus to such efforts.

2. The majority's holding, by eliminating the purchaser-seller requirement of Section 18(a), defeats the salutary purposes of that requirement which were recognized by this Court in *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 737-749, and which led it to uphold such a requirement as necessary to avoid the "danger of vexatious litigation which could result from a widely expanded class of plaintiffs". 421 U.S. at 740, 743-749; see also *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 478-479.

3. This Court has noted that serious problems arise when a remedy which "would significantly broaden the class of plaintiffs who may seek to impose liability upon accountants and other experts who perform services or express opinions with respect to matters under the [federal securities] Acts" is judicially implied, and has emphasized that "we are not the first court to express concern that the inexorable broadening of the class of plaintiff who may sue in this area of the law will ultimately result in more harm than good". *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 214 n.33; *Blue Chip Stamps* v. *Manor Drug Stores*, *supra*, 421 U.S. at 747-748. The substantial consequences to the accounting profession resulting from the majority's judicial creation of a remedy under Section 17(a) raise precisely those concerns of which this Court has expressed its awareness

and make this case an important one which merits this Court's review.[18]

4. There is also a serious question as to the need for the majority's holding. The claims asserted here, and the similar claims which might be asserted by any brokerage firm customer for misstatements in Section 17(a) reports, are essentially common law claims for accountants' negligence and malpractice, which traditionally have been a concern of state law and for which state law provides appropriate remedies.[19] The "federalizing" of such common law claims by means of Section 17(a), and the consequences which result therefrom, raise important questions which should be decided by this Court.

5. The majority's holding also raises important issues of statutory construction, including whether the Court of Appeals majority has usurped the legislative function by

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[18]This is particularly so since Section 17(a), which imposes reporting obligations on every "national securities exchange", every "broker or dealer" and every "registered securities association", does not even mention accountants. Rule 17a-5(b)(1) does call for reports of financial condition required of broker-dealers to be "certified by a certified public accountant or a public accountant who shall be in fact independent"; but there is a serious question as to whether any duty thereby is placed on accountants, and if it is, whether any duty not set forth in Section 17(a) can be derived from Rule 17a-5, because it is well-established that "the language of the statute must control the interpretation of the Rule". *Santa Fe Industries, Inc.* v. *Green*, *supra*, 430 U.S. at 472; see also *Ernst & Ernst* v. *Hochfelder*, *supra*, 425 U.S. at 214 ("[The] scope [of the rule] cannot exceed the power granted the [SEC] by Congress").

[19]The *unnecessary* nature of the burden placed upon the federal courts by the Second Circuit's creation of a Section 17(a) implied right of action is further demonstrated by the fact that not only do the Trustee and SIPC have pending the State Court Action (see p. 4 and n.2), but customers of Weis also have pending New York state court actions against Touche Ross for damages allegedly resulting from Touche Ross' certification of the Weis financial reports, *Rosen* v. *Touche Ross & Co.* (Sup. Ct. N.Y. County, Index No. 21572/77) and *Rich* v. *Touche Ross & Co.* (Sup. Ct. N.Y. County, Index No. 23193/76).

substituting its own judgment for that of Congress with respect to what federal damage remedies are necessary and appropriate to effectuate the purposes of Section 17(a). *Cf. Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 65 ("Even were we to agree . . . that granting [plaintiff] a right of action against the Exchange would 'accord' with the purpose of the [1934] Act, our function here is to discern the intent of Congress, not to legislate in its place"), cited in the dissenting opinion below (33a).

6. This case also is significant because the Weis liquidation is the largest brokerage firm liquidation since the enactment of SIPA, SIPC SEVENTH ANNUAL REPORT (1977) 5-6; and, it is an important one for the litigants since it involves claims for aggregate damages of $65,000,000.[20]

B. The Question Of Whether The Trustee And SIPC May Assert Any Section 17(a) Rights Should Be Decided By This Court

The holding of the Court of Appeals majority that the Trustee and SIPC may assert, as "bailee" and

[20]In view of the importance of the questions raised by this Petition, the fact that the judgment sought to be reviewed is nonfinal (the Court of Appeals having reversed an order granting a Rule 12(b) motion to dismiss) should not impede the granting of certiorari. This Petition raises clear-cut issues of law which are fundamental to the further conduct of the case; reversal of the judgment would in fact terminate the action. This Court has granted certiorari in other cases which were at a similar procedural stage, where those cases raised similarly important issues affecting the administration of the federal securities laws. *E.g., Blue Chip Stamps* v. *Manor Drug Stores, supra; United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837 (1975); see *Daniel* v. *International Brotherhood of Teamsters,* 561 F.2d 1223 (7th Cir. 1977) (affirming district court's denial of Rule 12(b) motion), *cert. granted,* 98 S. Ct. 1232 (1978); cf. *Ernst & Ernst* v. *Hochfelder, supra* (the Court of Appeals had reversed an order granting summary judgment and had remanded the action for trial).

"subrogee", respectively, the Section 17(a) claims of certain Weis customers against Touche Ross also should be reviewed by this Court. That holding is erroneous, is in conflict with this Court's decisions in *Caplin* and *Amtrak,* and raises such important questions for the administration of the federal securities laws as the propriety of the assertion of customer claims against third parties by a SIPA trustee and by SIPC, and the appropriateness of permitting a SIPA trustee, SIPC and customers of a brokerage firm in liquidation all to assert simultaneously the same claims against a third party such as Touche Ross.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

August 23, 1978

Respectfully submitted,

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APPENDIX

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 136, 144—September Term, 1977.

(Argued November 14, 1977—Decided April 21, 1978.)

Docket Nos. 77-7183, 77-7186

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,

Plaintiffs-Appellants,

—v.—

TOUCHE ROSS & CO.,

Defendant-Appellee.

Before:

LUMBARD, MULLIGAN, and TIMBERS,

Circuit Judges.

Appeal from order of the Southern District of New York dismissing complaint. Inzer B. Wyatt, *J.*, ruled that neither SIPC nor broker's trustee in liquidation could maintain suit against accountant under section 17 of the Securities Exchange Act.

Reversed as to both plaintiffs and remanded.

JAMES B. KOBAK, JR., New York, N. Y. (Hughes Hubbard & Reed, John S. Allee, John W. Schwartz and Harold L. Kaplan, New York,

New York, on the brief), *for Plaintiff-Appellant Edward S. Redington, as Trustee for the liquidation of the business Weis Securities, Inc.*

CLARENCE FRIED, New York, N. Y. (Hawkins, Delafield & Wood, Philip R. Forlenza and Rafael Pastor, New York, N. Y., on the brief), *for Plaintiff-Appellant Securities Investor Protection Corporation.*

ARNOLD I. ROTH, New York, N. Y. (Rosenman Colin Freund Lewis & Cohen, Eugene Zemp DuBose, Jr. and Arthur S. Linker, New York, N. Y., on the brief), *for Defendant-Appellee.*

PAUL GONSON, Associate General Counsel; James H. Schropp, Assistant General Counsel; Theodore S. Bloch, Attorney, Securities and Exchange Commission, Washington, D. C., on the brief, *Amicus Curiae.*

LUMBARD, *Circuit Judge:*

In this appeal, rising out of the insolvency and liquidation of the brokerage firm of Weis Securities, Inc. ["Weis"], we are presented with the question whether a private cause of action exists under section 17 of the Securities Exchange Act of 1934[1] against account-

[1]15 U.S.C. § 78q (1976). This section was amended in 1975; in 1972, the date relevant to the instant case, it read, in relevant part:

(a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors.

ants who prepare misleading statements of a broker's financial affairs, and if so, who may maintain such an action.

The district court dismissed the claims herein of the Securities Investor Protection Corp. ["SIPC"][2] and of Edward S. Redington, Weis' Trustee in Liquidation ["Trustee"], believing that no claim for relief was stated because no cause of action could be implied from section 17.[3] *Redington* v. *Touche Ross & Co.*, 428 F. Supp. 483 (S.D.N.Y. 1977). We conclude that customers of a broker have a right of action against an accountant whose audits of the brokerage firm are false or misleading. Because we believe that SIPC and the Trustee are appropriate parties to seek (between them) total recovery of the customers' damages, we reverse and remand.

I

Touche Ross & Co. ["Touche Ross"] served as Weis' independent certified public accounting firm from 1969 to 1973. In that capacity, Touche Ross prepared annual audits of Weis' affairs as required by section 17 and regulations thereunder.

The complaint herein alleged that during fiscal 1972, certain of Weis' officers conceived and executed a scheme to conceal from the regulatory authorities and

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[2]SIPC was created by the Securities Investor Protection Act of 1970, Pub. L. No. 91-598, 91st Cong., 2d Sess., 84 Stat. 1636, *codified* at 15 U.S.C. §§ 78aaa-78*lll* (1976).

[3]Our decision in this case has been materially aided by the brief *amicus curiae* submitted on appeal by the SEC. Judge Wyatt did not have the advantage of the SEC's position in this matter.

Judge Wyatt also dismissed, for lack of subject matter jurisdiction, five state common-law claims which the Trustee had sought to bring under principles of plenary bankruptcy or pendent jurisdiction, and four state common-law claims by SIPC, with respect to which diversity of citizenship had been alleged. Judge Wyatt ruled that SIPC was not a District of Columbia corporation for purposes of jurisdiction, and that complete diversity did not exist. Because of the view we take of the case, we need express no opinion as to the scope of bankruptcy jurisdiction in SIPA-receivership cases, nor as to the citizenship of SIPC.

the public Weis' dire financial condition.[4] The elements of this scheme appear in great detail in the complaint; for example, although Weis had suffered a loss for fiscal 1972 of greater than $1.5 million, its pre-tax earnings for that year were stated as being around $1.7 million.

When Weis' fiscal 1972 ended on May 26, 1972, Touche Ross proceeded to prepare and certify Weis' financial statements, and to answer the financial questionnaire required by the New York Stock Exchange of its member firms. In four opinion letters, dated July 7, July 7, July 21 and July 21 (all of 1972), Touche Ross represented that it had examined (i) the statement of Weis' current financial condition; (ii) Weis' answers to the financial questionnaire; (iii) Weis' consolidated balance sheet for the past year; and (iv) Weis' consolidated statement of earnings for the past five years, and found that each presented fairly and accurately the financial picture of Weis, in conformity with generally accepted accounting procedures.

In fact, Weis' financial condition was not as stated in the above four documents, but was far more precarious. As no steps were taken to attempt to remedy Weis' situation, it continued to deteriorate.[5] On May 24, 1973, the SEC sought an injunction preventing Weis and its officers from continuing to violate the '34 Act, and SIPC applied for a decree, pursuant to 15 U.S.C. § 78eee(a)(2), adjudging Weis' customers in need of protection under SIPA. Accordingly, Weis' liquidation was ordered by (then) District Judge Gurfein on May 30,

[4]In this posture of the case, we take—as we must—that view of the facts most favorable to plaintiffs, treating as true the allegations of the complaint. *See Escalera* v. *New York Housing Auth.*, 425 F.2d 853, 857 (2d Cir. 1970).

[5]Plaintiffs contend that the misleading statements certified by Touche Ross were the direct cause of the failure to take any remedial action, such as the infusion of capital or merger with another firm. Thus, they assert, Touche Ross' dereliction substantially contributed to Weis' forced liquidation and plaintiffs' losses. These contentions will be discussed more thoroughly in the body of the opinion.

1973, and Edward Redington was appointed Trustee for the liquidation.

SIPC and the Trustee jointly began an action against Touche Ross in New York state court on July 3, 1975. *Redington* v. *Touche Ross & Co.*, No. 13996/76 (Sup. Ct. N. Y. County). The common allegations of the plaintiffs in the state court complaint were the same as those in the instant case, except that three paragraphs dealing with claims under section 17 of the '34 Act were omitted. Five of the Trustee's six present "causes of action" appear in identical form in the state action, as do four of SIPC's eight present claims. The additional claims in this action are the federal securities law claims.

The instant suit was commenced on April 30, 1976. Under federal law and state common law, SIPC seeks to recover $14 million, either as subrogee of Weis' customers whose claims it has paid under SIPA, or as a member of the group directly injured by Touche Ross' delicts. Likewise under federal law and state common law, the Trustee is claiming $51 million; he contends that he may recover either by standing in the shoes of Weis' customers, since under SIPA, his is the responsibility to marshal and return their property,[6] or by standing in the shoes of Weis itself, since, he alleges, Weis—as an entity distinct from its conniving officers—was directly damaged by Touche Ross' unsatisfactory audit.

SIPC and the Trustee appeal from Judge Wyatt's order dismissing the complaint for failure to state a claim on which relief could be granted (with respect to the section 17 counts). Touche Ross asks us, in the event we reverse, to stay the federal action in favor of the state

[6]Property on hand when Weis was liquidated permitted the Trustee to return to customers 67% of the property they should have received. In addition, SIPC paid out some $14 million to customers and other creditors. Since under 15 U.S.C. § 78fff (1976), accounts are protected only up to $20,000 in cash and $50,000 in cash and securities, there may remain customers with uncompensated losses, who therefore retain claims against those who caused their losses. It is these claims that we hold the Trustee may assert. *See* part III B *infra*.

court suit.[7] This last issue, evidently, is one which Judge Wyatt has never had cause to consider.

II

The first question we address is whether customers of a brokerage firm are given any remedy by the '34 Act against accountants whose section 17 reports are false or misleading. There are two major considerations involved in this decision: the criteria laid down by the Supreme Court in *Cort* v. *Ash,* 422 U.S. 66 (1975), for finding an implied right of action in a statute which is silent on the issue; and the "purchase or sale" requirement reaffirmed by the Court in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975).

One preliminary matter must be dealt with. Judge Wyatt held that section 17 "was designed to supply administrative guidance in the bookkeeping area and not to create rights in anybody," and that it "does not impose any duty on accountants." 428 F. Supp. at 489, 491. We believe that, even if no right of action were implied, to see nothing but "administrative guidance" in a provision as crucial to the regulation of brokers as section 17 is to take far too narrow a view of the statute. Certified public accountants play a significant role in the scheme created by the '34 Act for the regulation of securities trading, as is recognized by the regulations promulgated by the SEC.[8] *See, e.g.,* 17 C.F.R. § 240.17a-5(b), (f), (g), (h), (i), (m). It is well established that section 10(b) of the '34 Act and rule 10b-5

[7]Plaintiffs aver that the state court action was commenced first only in a highly technical sense. It was begun by service of a summons without complaint (the complaint was not served until after the filing of the federal complaint), and then apparently ignored for some months by mutual consent. The parties agree that the state suit has progressed to the extent of responses by each plaintiff to one set of defendant's interrogatories.

[8]For a discussion of the functions and duties of accountants in this context, see *In re* Touche, Niven, Bailey & Smart, 37 S.E.C. 629, 5 Fed. Sec. L. Rep. (CCH ¶72,100, at 62,212 (1957); Note, *Accountants' Liability for False and Misleading Financial Statements,* 67 Colum. L. Rev. 1473 (1967).

thereunder impose a duty on accountants, for breach of which they may be sued. *See Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976). We hold that section 17 of the '34 Act likewise imposes a duty on accountants.

A

The factors cited in *Cort* v. *Ash, supra,* 422 U.S. at 78, familiar through much repetition, which bear on the propriety of finding an implied right of action in a statute are:

> 1) Whether plaintiffs belong to the class for whose special benefit the statute was enacted;
>
> 2) Whether there is any indication of legislative intent on the issue;
>
> 3) Whether implication of a right of action is consistent with the policies behind the legislative scheme; and
>
> 4) Whether the cause of action in question is one traditionally relegated to state law.

A consideration of these four factors convinces us that implication of a right of action in favor of Weis' customers is appropriate.

1. The language of section 17, the SEC rules in the 17a-5 series, and an analysis of the role played by accountants' reports in the regulation of brokers make clear the extent to which Weis' customers are members of a class peculiarily protected by section 17.

The documents and reports that the SEC is empowered to require of brokers must be "necessary or appropriate in the public interest *or for the protection of investors*." 15 U.S.C. § 78q(a) (emphasis added). The

same is true of the examinations that the SEC is empowered to conduct. *Id.*[9]

In order to provide a complete and accurate picture of a broker's financial condition, the SEC requires that the broker enlist an independent accountant to audit and certify its statements, list any matters to which the accountant takes exception, and provide certain additional financial data. Rule 17a-5(b), (i) (k). Furthermore, a notice of any "material inadequacies" found by the accountant in the broker's procedures must be sent to the broker's customers. Rule 17a-5(m)(3).[10]

The function of this arsenal of financial reports is to protect the broker's customers. One of the main methods adopted by the SEC to shield customers is the net capital rule, in either the form promulgated by the SEC, rule 15c3-1, or the stricter version enforced by the New York Stock Exchange, Exchange Rule 325.

The net capital rule is a requirement that a broker maintain a certain minimum ratio of liquid assets to aggregate indebtedness; its "principal purpose . . . is to require that the capital position of a broker . . . will always be sufficiently liquid to cover his current indebtedness, in order to be able at all times to promptly meet [sic] the demands of customers." Exchange Act Release No. 8024, 6 Fed. Sec. L. Rep. (CCH) ¶ 72,129 (1967). As amended in order to take into account the creation of SIPC, the rule serves particularly to "protect customers prior to the time when the broker's . . . assets would be sufficient to satisfy customers in the event of liquidation."

[9]In 1957, when the SEC expanded certification requirements for section 17 reports,

> that step represented the Commission's considered view that certification and reporting requirements constituted a valuable regulatory tool for the protection of a customer in respect of the risks involved in leaving his money and securities with his broker-dealer.

SEC, *Study of Unsafe and Unsound Practices of Brokers and Dealers,* H. Doc. No. 92-231, 92d Cong., 1st Sess., at 24 (1971).

[10]Citations to rule 17a-5 are to 17 C.F.R. § 240.17a-5 as it existed in 1972. Rule 17a-5(j)-(o) were adopted on June 30, 1972, and appear in the *Federal Register* for July 21, 1972.

tion." Exchange Act Release No. 11,497, [1975-76 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,212.

It is the reporting system created by section 17 that provides the SEC and other regulatory authorities with the information needed to enforce the net capital rule. Thus, a failure to supply accurate reports will leave the customers without protection until the broker's insolvency can no longer be concealed, and liquidation follows.

2. We find no indication, either in the statute itself or in its legislative history, of any congressional intent either to create a private remedy under section 17 or to deny one.[11]

The legislative history of the section is mute on the issue, leading to the conclusion that Congress never *explicitly* considered the question. Nor can it be said that Congress *implicitly* chose to deny a private right of action; section 17 is distinctly different in an important respect from statutes as to which such implicit intent has been found.

In *SIPC* v. *Barbour*, 421 U.S. 412 (1975), the Supreme Court noted that SIPA manifested a specific legislative intent to restrict enforcement to the SEC. *Id.* at 420, 425. In *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453, 458 (1974), a similar exclusivity was found to rest with the Attorney General; in *Cort* v. *Ash* itself, *supra,* 422 U.S. at 74-76, the Federal Election Commission was held to be the agency charged with exclusive enforcement.

We have recently indicated that an intent to commit enforcement of the securities statutes exclusively to the SEC will not readily be implied. *Abrahamson* v. *Fleschner,* 568 F.2d 862, 874 n.19 (2d Cir. 1977).

[11]To the extent that the court below relied on the remedy created by section 18 of the '34 Act as evidence of a legislative intent to deny a private remedy for violations of section 17, its concerns will be treated in part II B *infra.*

Nothing in section 17 induces us to treat it as an exception to this rule.

3. "Absent specific statements of legislative intent, we must examine the legislative purposes underlying the Act." *Abrahamson* v. *Fleschner, supra,* 568 F.2d at 874, conclude that a private right of action under section 17 is consistent with those purposes.

A partial list of the many sections of the securities acts under which private remedies have been implied appears in *Franklin National Bank* v. *L. B. Meadows & Co.,* 318 F. Supp. 1339, 1341-42 (E.D.N.Y. 1970). *See* III L. Loss, Securities Regulation 1785 (2d ed. 1961). At least since *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964) (section 14(a)), it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons; those persons may sue for the 'statutory tort' committed when the duty is breached.

We have held that section 17 imposes a duty on accountants in favor of brokers' customers. We note that—just as in *Borak*—the SEC was not meant to, and does not have the resources to examine and audit all the documents that it receives (in *Borak,* proxy statements; here, section 17 reports).[12] Both it and SIPC, as well as the broker's customers must rely on the certification by the accountants.

Neither SEC injunctive actions nor criminal prosecutions will restore to customers the money they have lost. Indeed, the cases cited by Judge Wyatt in support of the proposition that there exists injunctive and criminal relief for violations of section 17 do not involve

[12]In its *amicus* brief, the SEC advises us that, in fiscal 1976, over 5000 brokers and dealers were registered with it; that each of the approximately 750 broker-dealers that are not members of self-regulating organizations must be audited annually, as must the 500 or so against whom complaints are lodged; and that this leaves the SEC able to examine each year the statements of only 5% of broker-dealers who are apparently untroubled members of self-regulatory organizations.

accountants. *See* 428 F. Supp. at 490, and cases cited. Accordingly, we rule that a private remedy is an essential supplement to the scheme of enforcement of section 17.

4. Finally, it is evident that just as the problems caused by insolvent brokers are national in scope, so must be the standards governing their reporting. Section 17 is part of a statute as to which federal courts have exclusive jurisdiction; state law protection of brokers' customers varies widely. There is no reason to believe that the remedy sought herein is one traditionally relegated to state law.

B

The court below found a particularly high barrier to plaintiffs in section 18 and the judicially created purchaser-seller doctrine. 428 F. Supp. at 489-90. Section 18 creates private remedy for "misleading statements" in "any application, report, or document filed pursuant to this chapter," in favor of "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . ." 15 U.S.C. § 78r.

Applying this language, and the holding of *Blue Chip Stamps, supra,* 421 U.S. at 736, Judge Wyatt ruled that the remedy provided by section 18 was exclusive, and that thus no remedy existed for brokers' customers injured as a result of an accountant's misleading statements, absent a purchase or sale of an affected security. We disagree.

Since any misstatement in a section 17 report would not affect the price of the shares of the various issuers in the hands of a broker's customers, a strict application of section 18's limiting language would leave customers without any remedy whatsoever, no matter how egregious the fraud or how grievous their loss. Yet it is plain that brokers' customers are favored wards of section 17. We cannot agree that Congress simultaneously sought to protect a class and deprived the class of the means of protection.

Our holding is not inconsistent with either the purchaser-seller limitation or section 18, which will continue to apply to all investors in market securities who seek relief *qua* investors. That is, the *Blue Chip* doctrine would bar a suit by an investor who claimed to have been induced *not* to purchase or sell by a misstatement. We do not believe, however, that the doctrine applies to brokers' customers, protection of whom is wholly independent of protection of investors per se.

III

In light of the foregoing analysis, we decide that brokers' customers have a right of action against accountants for certifications that violate the standard set by section 17 and rule 17a-5. This does not, however, resolve the question whether the plaintiffs in the instant case, SIPC and the Trustee, are proper parties to bring the action.

A

SIPC asserts a right to bring this action both in its own right and as subrogee of the customers whose claims it has paid. We hold that SIPC may maintain the action as subrogee.[13]

SIPA provides expressly that SIPC, upon reimbursing a customer's losses, shall be subrogated to that customer's claims against the debtor's (here Weis')

[13]We need not reach the question whether SIPC could ever have a claim for damages other than on behalf of a broker's customers; we only note that as the creature of a 1970 statute, SIPC can hardly claim to have been a specially protected beneficiary of the '34 Act. SIPC makes much of 15 U.S.C. § 78bbb (1976), which treats SIPA as if it "constituted an amendment to, and was included as a section of" the '34 Act. Nonetheless, it is indisputable that SIPC is not the kind of entity Congress sought to protect either in 1934 or in 1970; the cited portion of the 1970 statute appears to do no more than indicate that, except where specifically provided otherwise, any remedy created by SIPA is supplemental to the preexisting remedies of the '34 Act.

estate. 15 U.S.C. § 78fff(f)(1). Touche Ross contends that SIPC's statutory right of subrogation against the debtor's estate is its exclusive remedy, precluding any rights against third parties such as Touche Ross. We disagree.

Section 78fff is a detailed blueprint for the distribution of the liquidated debtor's estate, and it is to be expected that SIPC's rights against the estate would be included in that section. However, there is no reason to believe that this was meant to destroy SIPC's general common-law right of equitable subrogation.

> [T]he general rule is that upon payment of a loss the insurer is entitled to be subrogated pro tanto to any right of action which the insured may have against a third person whose negligence or wrongful act caused the loss.

31 N.Y. Jur., *Insurance* § 1620, at 510. *See Ackerman* v. *Motor Vehicle Accident Indemnification Corp.*, 18 App. Div. 2d 307, 239 N.Y.S.2d 463 (1st Dept. 1963) (explicit statutory provision did not destroy MVAIC's broader common-law right to subrogation).

Moreover, we believe that it is more in keeping with the intent of Congress that wrongdoers not receive a windfall benefit from the existence of SIPC, and that SIPC be able to recoup its losses from solvent wrongdoers. Accordingly, we find that SIPC is subrogated to the right of action implied in section 17 in favor of brokers' customers against third parties such as accountants. *See SEC* v. *Albert Maguire Securities Co.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 96,129, at 92,076 (3d Cir. July 27, 1977).

B

The Trustee contends that he is a proper plaintiff herein, both as the representative of Weis' estate and as bailee of Weis' customers' property. We hold that he may maintain this action on behalf of such customers as have not been fully reimbursed by SIPC.

The barriers to a right of action on Weis' behalf are insurmountable. It is apparent that brokers, such as Weis, were not included in the class of those *protected* by section 17; indeed, brokers are the very entities *regulated* by section 17.

Two recent cases in point are *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), and *Lank* v. *New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977). In each, a member of the class sought to be regulated by Congress attempted to claim the benefit of an implied right of action under the very statute that regulated it. *Chris-Craft* held that a defeated tender offeror could not enforce the Williams Act, 15 U.S.C. § 78o(e), against a successful tender offeror, because "a party whose . . . conduct was purposefully brought under federal control by the statute . . . can scarcely lay claim to the status of 'beneficiary' whom Congress considered in need of protection." 430 U.S. at 37.

In *Lank*, we decided, in a case not unlike the instant case, that the receiver of a liquidated brokerage firm could not—because the firm itself could not—sue a securities exchange for failure to force the firm to comply with the exchange's rules. We pointed out that the '34 Act did not afford protection "to the very members of the stock exchanges whose conduct was being regulated." 548 F.2d at 66. The extent to which *Lank* parallels the instant case precludes our holding that the Trustee may maintain this action on Weis' behalf.

However, none of the above considerations apply to an action brought by the Trustee as bailee of the property of Weis' customers. He is responsible for marshalling and returning their property; to the extent that he is unable to do so, he argues, he may sue on behalf of the customer/bailors any wrongdoer whom they could sue themselves.

Rule 17(a) of the Federal Rules of Civil Procedure reads, in part: "[A] . . . bailee . . . may sue in his own name without joining with him the party for whose

benefit the action is brought. . . ." The Advisory Committee Notes to this section, added in 1966,[14] point out by way of illustration that the "owner of a warehouse in which household furniture is stored is equally entitled to sue on behalf of the numerous owners of the furniture stored." 39 F.R.D. 69, 85 (1966). *See generally* 5 N.Y.Jur., *Bailments* §§ 118, 119.

To the extent that customers have claims that have not been satisfied either by Weis in liquidation, *see* note 6 *supra*, or by SIPC, they retain rights of action against Touche Ross. We hold that the Trustee, as bailee, is an appropriate real party in interest to maintain this action on their behalf.

IV

Since we hold that both SIPC and the Trustee may maintain this action against Touche Ross, we remand to the district court for further proceedings consistent with this opinion. We leave to it in the first instance a number of questions that will now arise: whether to stay the federal action pending determination of the state action;[15] whether to exercise pendent jurisdiction over the plaintiffs' common-law claims; and what the appropriate standard is for accountant liability in actions under section 17, *cf. Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185 (1976).

Reversed and remanded.

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[14]The purpose of the 1966 amendment was "[to] add to the illustrative list of real parties in interest a bailee—meaning, of course, a bailee suing on behalf of the bailor with respect to the property bailed." 39 F.R.D. 69, 84 (1966).

[15]In *Weiner* v. *Shearson, Hammill & Co.*, 521 F.2d 817 (9th Cir. 1975), the court of appeals chose to remand the question of a stay to the district court, despite its thorough discussion of the factors involved in the determination of the question.

TIMBERS, *Circuit Judge,* concurring:

I concur in all respects in Judge Lumbard's clear, concise and, in my view, correct majority opinion.

In view of the characteristically thoughtful and earnest dissent of our Brother Mulligan, however, I should like to add a few words, partly to supplement Judge Lumbard's opinion, but chiefly to suggest that Judge Mulligan's dissent be read in the light of the following observations.

First, in urging that customers of a broker-dealer in liquidation have no implied right of action for damages under Section 17 of the Exchange Act against accountants who prepare false or misleading reports required by that statute, the dissent understandably is disturbed by the *unanimous* opinion in *Cort* v. *Ash,* 422 U.S. 66, 78 (1975), as recently reaffirmed in *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 37-45 (1977). Granted that the dissent's massive effort to distinguish or to apply a gloss to *Ash* is an artful attempt to circumvent this key decision, I fear that our dissenting colleague has misapprehended the essential purpose of *Ash* in stating certain factors to be taken into consideration in determining whether to imply a right of action under a given statute. The dissent at the outset, *post,* at , emphasizes that *Ash* is not relevant to a case which arises under a statute which expressly provides for a private right of action. This overlooks the fact that the Supreme Court specifically applied the *Ash* analysis in *Piper, supra,* 430 U.S. at 37-41, in determining whether a private remedy was implicit in Section 14(e) of the same statute with which we are here concerned, i.e. the Exchange Act. Assuming that what the dissent intends to emphasize, *post,* at , is that *Ash* does not apply when an *express remedy* is provided for the *specific wrong* complained of, it must be remembered that the Court reaffirmed the implication of a private right of action under Section 10(b) of the Exchange Act and Rule 10b-5 promulgated

thereunder in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 730 (1975), despite the absence of legislative history on the subject, *id.* at 737, much less "clear contrary evidence of legislative intent." *Post,* at .

Second, the dissent's displeasure with *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964), likewise is understandable. This seminal opinion written by the late Mr. Justice Tom Clark for a *unanimous* Supreme Court, in holding that Section 27 of the Exchange Act provided the jurisdictional underpinning for an implied private right of action for damages (as well as for declaratory and equitable relief) arising from violations of Section 14(a) of the Exchange Act, *id.* at 430-35, expressly recognized that "Private enforcement of [Commission rules] provides a necessary supplement to Commission action", *id.* at 432, and, that "[I]t is the duty of the courts to be alert to provide such remedies as are necessary to make effective the congressional purpose." *Id.* at 433. Despite our Brother Mulligan's herculean effort in dissent to buttress his assertion that *Borak* "has been significantly restricted by more recent decisions of the Supreme Court", *post,* at , those decisions strike me as expressly and emphatically reaffirming the *Borak* rule[1]—as Mr. Justice Stevens stated in *Piper, supra,* 430 U.S. at 67, "*Borak* remains a viable precedent."

Third, the dissent speaks disparagingly of the SEC amicus brief. *Post,* at 2725 n.1. As Judge Lumbard correctly points out, *ante,* at 2707 n.3, we were aided materially by the SEC brief, whereas the district court did not have the advantage of knowing of the SEC's position. Here again, our Brother Mulligan's attempt to disparage the SEC brief is understandable, for it urges forcefully and cogently that SIPC should be permitted to assert a private right of action under Section 17 of the

[1]For example, in *Piper, supra,* 430 U.S. at 25, Chief Justice Burger stated:

> "This Court has nonetheless held that in some circumstances a private cause of action can be implied with respect to the

Exchange Act under the circumstances of this case. But far more basic than whether the SEC as amicus supports or opposes one side or the other in litigation under the federal securities laws, *is that the position of the SEC should be known to the court.* That is the point of Judge Lumbard's observation referred to above. And it is especially important in a case of first impression such as the instant one involving a statute under which Congress has imposed on the Commission specific responsibilities.[2] Wholly aside from the instant case—where I find the

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1934 Act's antifraud provisions, even though the relevant provisions are silent as to remedies. *J. I. Case Co.* v. *Borak,* 377 U.S. 426 (1964) (§14(a)); *Superintendent of Ins.* v. *Bankers Life & Cas. Co.,* 404 U.S. 6, 13 n. 9 (1971) (¶10(b))."

In *SIPC* v. *Barbour,* 421 U.S. 412, 417 (1975), referring to *Borak,* Mr. Justice Marshall summarized its holding:

> "In light of the 'broad remedial purposes' of the Act and the SEC's representation that private enforcement was necessary to effectuate those purposes, the Court held that the action for damages could be maintained."

And in *Blue Chip Stamps, supra,* 421 U.S. at 730, after summarizing the 25 year development of the decisional law that there is an implied private right of action under Rule 10b-5, Mr. Justice Rehnquist, referred to *Borak* as follows:

> "Such a conclusion was, of course, entirely consistent with the Court's recognition in *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 432 (1964), that private enforcement of Commission rules may '[provide] a necessary supplement to Commission action.'"

These decisions do not strike me as significantly "restricting" *Borak;* rather, they seem quite clearly to reaffirm *Borak* as a "viable precedent", each case turning of course on the particular statute or rule under consideration.

[2]Section 7 of SIPA, 15 U.S.C. §78ggg (1976). See *SIPC* v. *Barbour, supra,* 421 U.S. at 417.

The SEC cogently summarizes in its brief filed in our Court its interest in the instant appeal as follows:

> "The Commission respectfully submits this brief as *amicus curiae* because this appeal raises significant issues which could materially affect its administration of the federal securities laws. We believe . . . that permitting a private right of action under Section 17 of the Securities Exchange Act will provide a necessary supplement to the Commission's efforts to enforce that section and the rules and regulations thereunder. In addition, financial statements submitted by broker-dealers

SEC amicus brief to measure up to the Commission's high standard of competence and fairness—I do hope that our Brother Mulligan's disparagement of the SEC amicus brief will not be construed as a judicial signal, even in dissent, that the Commission should retreat to its position of a generation ago which drew sharp criticism from our Court. *Compare Blau* v. *Mission Corp.,* 212 F.2d 77, 81 (2 Cir.), *cert. denied,* 347 U.S. 1016 (1954), and *Roberts* v. *Eaton,* 212 F.2d 82, 84 (2 Cir.), *cert. denied,* 348 U.S. 827 (1954), *with Studebaker* v. *Gittlin,* 360 F.2d 692, 695 (2 Cir. 1966), and *Greene* v. *Dietz,* 247 F.2d 689, 695-98 (2 Cir. 1957) (concurring and dissenting opinions; per curiam opinion on rehearing). *See Some Practical Aspects: The SEC and The Federal Judiciary,* 41 A.B.A.J. 1136, 1137-38 (1955).[3]

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pursuant to the Act play a key role in the Commission's administration and enforcement of various statutory provisions designed to protect against loss of the funds and securities of customers of broker-dealers and to maintain confidence in the securities markets at a high level. The availability of a right of action under Section 17 will thus have a direct bearing on the overall effectiveness of such statutory and regulatory provisions as those regarding hypothecation and segregation of securities and cash, and the net capital rule, designed to ensure the ability of brokers to meet their financial obligations as custodians of customer property. In addition, the Commission has 'plenary authority' with respect to the operations of the Securties Investor Protection Corporation, and is therefore concerned that SIPC have the ability to recover funds needlessly expended due to the wrongful acts of others, thus preserving the funds available to compensate losses suffered by the customers of brokers." (footnotes omitted). SEC Amicus Curiae Brief, filed August 31, 1977, at 3-4.

[3]I am pleased to note that, in response to my concurring opinion, Judge Mulligan very commendably has disclaimed any intention to disparage the SEC amicus brief below, n.1, last paragraph. This reflects the good judgment and fairness for which our distinguished colleague is well known. As a former Dean of the Fordham Law School, I think that Judge Mulligan would join in taking judicial notice of one of the leading expositions of the history and functions of the amicus curiae through centuries of development of the law. Beckwith and Sobernheim, Amicus Curiae—MINISTER OF JUSTICE. 17 Fordham Law Review 38 (1948).

Accordingly, after carefully considering Judge Mulligan's dissenting opinion, especially in the light of the observations set forth above, I concur without qualification in Judge Lumbard's majority opinion.

MULLIGAN, *Circuit Judge* (dissenting):

In my view this case was properly decided by Judge Wyatt and the order and judgment dismissing the complaint should be affirmed.[1] The majority announces that "[a]t least since *J. I. Case Co.* v. *Borak*, 377 U.S. 426 (1964) . . . it has been accepted in securities law that when a statutory provision imposes a duty on someone in favor of a class of protected persons, those persons may sue for the 'statutory tort' committed when the duty is breached." Majority opinion at 2715. The *Borak* rule, which liberally implied private actions in federal regulatory acts on a statutory tort theory, has been significantly restricted by more recent decisions of the Supreme Court which are misapplied by the majority opinion.[2]

[1]The majority comments in footnote 3 that its decision has been materially aided by the brief *amicus curiae* submitted on appeal by the SEC and that Judge Wyatt did not have the advantage of the SEC's position in this matter. The Supreme Court, however, in *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1. 41 n.27 (1977) observed that ". . . its [the SEC's] 'expertise' in the securities-law field is of limited value when the narrow legal issue is one peculiarly reserved for judicial resolution, namely whether a cause of action should be implied by judicial interpretation in favor of a particular class of litigants." That, of course, is the principal issue in this case as well. It should also be added that a substantial part of the SEC brief is devoted to the argument that SIPC in its own right may assert a private right of action for violations of section 17 of the '34 Act. This proposition was not only rejected below but was repudiated by the majority in its footnote 13.

I do not "disparage", as my Brother Timbers would have it, the brief of the SEC. I simply do not agree with it—neither does the majority, at least to the extent I have indicated. Nor do I dispute the propriety of its submission. I cannot believe that disagreement with the opinions of any agency can sensibly discourage the filing of a brief expressing its views as *amicus curiae (sed non parens curiae)*. It remains the function of the bench to construe the law as best it can even though that involves on occasion disagreement with one's colleagues or even an agency.

[2]These decisions discussed in the text, *infra*, include *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1 (1977), *Cort* v. *Ash*, 422

While the majority purports to consider the factors set forth in *Cort* v. *Ash*, 422 U.S. 66 (1975), it must be emphasized that Justice Brennan in his opinion in *Cort* carefully restricted their application: "In determining whether a private remedy is implicit in a statute *not expressly providing one*, several factors are relevant." 422 U.S. at 78 (emphasis supplied). In *Piper* v. *Chris-Craft Industries, Inc.*, 430 U.S. 1, 37 (1977) Chief Justice Burger's opinion similarly confined the *Cort* factors, noting that they are " 'relevant' in determining whether a private remedy is implicit in a statute *not expressly providing one*." (Emphasis supplied).

In the instant case, however, we are confronted with a statute for which Congress has clearly provided a remedy in the event of certain violations. Admittedly, section 17(a), set forth in footnote 1 of the majority opinion, does not itself include any private remedy for an infraction of its terms. It simply requires that brokers or dealers such as Weis, make, keep and preserve records and make such reports as the SEC may prescribe by its rules and regulations in the interest of the public and for the protection of investors. Other comparable sections of the '34 Act (the Act) also provide for the filing of reports. See sections 13(a), 15 U.S.C.§ 78m(a); 13(d), 15 U.S.C.§ 78m(d); 13(f), 15 U.S.C. § 78m(f); and 15

U.S. 66 (1975); *Securities Investor Protection Corp.* v. *Barbour*, 421 U.S. 412 (1975); *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers*, 414 U.S. 453 (1974) *(Amtrak)*; see *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975). Numerous commentators have acknowledged the substantial retreat from *Borak* represented by these subsequent Supreme Court rulings. E.g., Climan, Civil Liability Under the Credit-Regulation Provisions of the Securities Exchange Act of 1934, 63 Cornell L. Rev. 206, 261-69 (1978); Comment, Implying Private Causes of Action From Federal Statutes: *Amtrak* and *Cort* Apply the Brakes, 17 B.C. Ind. & Com. L. Rev. 53, 64 (1975); Comment, Private Rights of Action Under *Amtrak* and *Ash:* Some Implications for Implication, 123 U. Pa. L. Rev. 1392, 1416 (1975); Note, Implication of Private Actions from Federal Statutes: From *Borak* to *Ash*, 1 J. Corp. Law 371 (1976); 30 Vand. L. Rev. 905, 908-10 (1977).

(a), 15 U.S.C. § 78o(d). Like section 17(a), these sections include in their text no provisions for a private remedy.

Section 17 is immediately followed, however, by section 18(a), 15 U.S.C. § 78r(a), entitled "Liability for Misleading Statements" which does provide an express private remedy for violation of the reporting provisions of the Act. It states:

> Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to [the '34 Act] or any rule or regulation thereunder . . . , which statement was . . . false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have *purchased or sold a security* at a price which was affected by such statement, for damages caused by such reliance unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading.

(Emphasis supplied).

Section 18(a) follows upon the heels of section 17. Its subject matter covers reports or documents filed pursuant to the '34 Act and regulations promulgated thereunder. Thus, Judge Wyatt correctly found and, indeed, common sense would dictate, that section 18(a) expressly provides the sole private remedy which Congress intended to be available for a violation of section 17(a) and the other reporting sections of the '34 Act. Furthermore, most courts which have considered the issue have found section 18(a) to contain the only remedy for violation of the Act's reporting sections.[3]

[3] *Meer* v. *United Brands Co.*,[1976-77 Transfer Binder] CCH Fed. Sec. L. Rep. ¶95,648 at p. 90,213 (S.D.N.Y. 1976); *duPont* v. *Wyly*, 61 F.R.D. 615, 628 (D. Del. 1973); *In re Penn Central Securities Litigation*, 347 F.Supp. 1327, 1340 (E.D. Pa. 1972), relevant point adhered to on reargument, 357 F.Supp. 869 (E.D. Pa. 1973), aff'd, 494 F.2d 528, 539-40 (3d Cir. 1974); see *Myers* v. *American Leisure Time Enterprises, Inc.*, 402 F.Supp. 213, 214 (S.D.N.Y. 1975), aff'd without opinion, 538 F.2d 312 (2d Cir. 1976). But see the district court cases discussed in *In re Penn Central Securities Litigation, supra*, 494 F.2d at 540 n.18.

It should be noted that in a case related to that at bar the customers of Weis brought a class action against Touche Ross alleging, *inter alia*, that Touche Ross' certification of the same financial statements involved here was in violation of Rule 17a-5, 17 C.F.R. § 240.17a-5 and gave the customers a cause of action under section 18(a). *Rich* v. *Touche Ross & Co.*, 415 F.Supp. 95, 101-02 (S.D.N.Y. 1976). Judge Brieant dismissed the complaint, finding that since the plaintiffs did not meet the purchaser-seller requirements of 18(a) they stated no claim for the alleged violation of Rule 17a-5. Id. at 102-04.

It seems clear, then, that the statutory scheme enacted by Congress provides in section 18(a) an express but limited remedy for violations of section 17(a). As noted above, the Supreme Court has repeatedly limited use of the *Cort* factors to instances in which *no* statutory remedy whatsoever has been provided. Hence, it must seriously be questioned whether the *Cort* factors are even the appropriate analytical tool to determine whether an implied private right of action should exist for infractions of section 17(a). Nonetheless, using a *Cort* analysis the majority finds an implied private damage remedy because it determines that brokers' customers are "favored wards" of, and a class "peculiarly protected" by section 17. Therefore, states the majority, we cannot assume that the Congress intended to deprive them of "the means of protection." Majority opinion at 2716.

I believe the majority reasoning is faulty in two major respects. In the first place, if the brokers' customers were so clearly the concern of the Congress when it enacted section 17(a), its failure to afford them a private damage remedy in section 18(a), which was contemporaneously enacted and which provides a private remedy for misleading statements in reports filed pursuant to the mandate of the Act, leads to the conclusion that Congress did not intend a private damage remedy to be available to brokers' customers.

The principle of statutory construction by which one reaches this result is somewhat forbiddingly known as *"expressio unius est exclusio alterius"*. This maxim was recently emphasized and applied by the Supreme Court in *National Railroad Passenger Corp.* v. *National Association of Railroad Passengers,* 414 U.S. 453 (1974) (*Amtrak*). There the Court held that the plaintiff association of railroad passengers had no implied cause of action as primary beneficiaries of the Rail Passenger Service Act of 1970 since that Act expressly provided for enforcement by the Justice Department. In its opinion, the Court observed:

> A frequently stated principle of statutory construction is that when legislation expressly provides a particular remedy or remedies, courts should not expand the coverage of the statute to subsume other remedies. "When a statute limits a thing to be done in a particular mode, it includes the negative of any other mode." . . . This principle of statutory construction reflects an ancient maxim—*expressio unius est exclusio alterius.* Since the Act creates . . . a private cause of action only under very limited circumstances, this maxim would clearly compel the conclusion that the remedies created are the exclusive means to enforce the duties and obligations imposed by the Act.

414 U.S. at 458.

Soon after its decision in *Amtrak* the Supreme Court reaffirmed its reliance on the *expressio unius* principle in *Securities Investor Protection Corp.* v. *Barbour,* 421 U.S. 412, 418-19 (1975). In finding that the express statutory grant to the SEC of a right to seek injunctive relief to enforce duties under the Securities Investor Protection Act precluded an implied right in others to seek similar relief, the Court reiterated its observation in *Amtrak* that "express statutory provision for one form of proceeding ordinarily implies that no other means of enforcement was intended by the Legislature." Id. at 419.

Similarly, in the instant case the provision by Congress in section 18(a) of a narrow private cause of action for section 17(a) infractions militates strongly against our attributing to Congress a willingness to allow more expensive enforcement of the duties and obligations created by that section. Moreover, while the Court in *Amtrak* acknowledged that the *expressio unius* principle must "yield to clear contrary evidence of legislative intent," 414 U.S. at 458, the majority here concedes that it finds nothing in the language or legislative history of section 17(a) to indicate that Congress intended to create a private cause of action under that section. In my view appellants have failed to demonstrate the "clear contrary evidence" to rebut the conclusion that the limited express right of action under section 18(a) is the exclusive remedy for a breach of section 17(a).[4]

We find further support for the position that there is no private right of action implied under section 17(a) in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723 (1975). There the Court commented: "When Congress wished to provide a remedy [under the '34 Act] to those who neither purchase nor sell securities, it had little

[4] I do not overlook Judge Timbers' recent opinion in *Abrahamson* v. *Fleschner,* 568 F.2d 862 (2d Cir. 1977), petition for cert. filed, 46 U.S.L.W. 3588 (U.S. March 21, 1978) (No. 77-1279), which the majority cites to distinguish *Amtrak* and *Barbour* on the ground that those cases do not involve implication of private actions under the securities acts. It is important to note that in *Abrahamson,* where the court found a private right of action for damages implied for violations of section 206 of the Investment Advisers Act, 15 U.S.C. § 80b-6, Judge Timbers, in his opinion for the majority, repeatedly stressed that the Investment Advisers Act made *absolutely no provision* for express private actions. Id. at 872, 874, 875. The opinion in *Abrahamson* contrasts this omission to those other securities acts which contain "sections *expressly* granting injured parties a private action for damages." Id. at 874 (emphasis in original); see *Piper* v. *Chris-Craft Industries, Inc., supra,* at 24-25. Indeed, in this connection the opinion then refers specifically to section 18 of the '34 Act. Id. at 874 n.20. Judge Timbers concluded: "Had Congress provided explicitly for private damage actions it would be unnecessary to consider whether the remedy should be judicially implied." Id. at 875. This conclusion in *Abrahamson* is in fact strongly supportive of the analysis in this dissent.

trouble in doing so expressly" 421 U.S. at 734. Judge Wyatt's opinion below reviews several such sections of the '34 Act which impose liability on persons other than purchasers or sellers. 428 F.Supp. at 490. The presence of these provisions in the '34 Act reinforces the conclusion that the framing of the section 18(a) remedy in terms of purchasers and sellers of securities to the exclusion of customers of broker-dealers was an intentional congressional limitation on the class for whom a private action would be avilable in the event of a section 17(a) violation.

The Supreme Court in *Blue Chip* also addressed itself specifically to section 18:

> Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to "any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement. . . . It would indeed be anomalous to impute to Congess an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action.

421 U.S. at 736.

But that is precisely what the majority is imputing to Congress in this case. The misleading reports which create the basis for the claim here made were required to be filed by section 17(a) of the '34 Act and the remedy provided by section 18(a) concedely encompasses not broker-dealer customers but only securities purchasers or sellers.[5] I find that *Amtrak, Barbour* and *Blue Chip*

[5]It should be noted that in another suit arising out of the Weis debacle Judge Wyatt has sustained a section 18(a) claim asserted by a plaintiff bank which allegedly purchased securities of Weis in reliance on the section 17(a) reports involved in this case. *Exchange National Bank* v. *Touche Ross & Co.*, 75 Civ. 916 (S.D.N.Y.).

compel the conclusion that the omission was studied and that the implication of a damage action against accountants under this section is totally unwarranted. The majority cannot properly characterize this as a case where there is no explicit private remedy provided by Congress. Rather, it is a case in which the remedy provided was designed to exclude the class which is here seeking monetary relief. Thus, the majority's holding in my view goes beyond statutory construction; it amounts instead to judicial legislation.

II

The second flaw in the majority opinion is the failure to consider the impact of *Piper* v. *Chris-Craft Industries, Inc., supra,* in its discussion of the *Cort* factors. In *Piper* the Court, while again carefully limiting its holding to cases where the statute to be construed provides no private remedy, id. at 24-25, emphasized that private relief will be implied in favor of a particular class intended to be protected by the statute only when it is " 'necessary' " to effectuate Congress' goals. 430 U.S. at 25.[6] The inquiry called for is to ascertain the congressional purpose and to determine whether a private damage action by brokers' customers is a *necessary* adjunct, id., to accomplish the primary congressional goal embodied by the legislation. *Cort* v. *Ash, supra,* at 84.

The plain language of section 17 establishes the congressional concern that the SEC be kept on notice of the financial health and stability of registered broker-dealers through whom public investors purchase and sell securities.

[6]The underscoring of the element of necessity three times in the *Piper* opinion, 430 U.S. at 25, indicates the emphasis the Court wished to bring to this factor in determining whether a private remedy should be implied. *Piper,* therefore, is not simply a restatement or affirmation of *Cort* but adds a significant gloss. *Wilson* v. *First Houston Investment Corp.*, 556 F.2d 1235, 1239, 1240 (5th Cir. 1978).

The SEC itself has long recognized that the primary protection for brokers' customers lies in preventive monitoring: "customers do not open accounts with a broker relying on suit, judgment and execution to collect their claim—they are opened in the belief that a customer can, on reasonable demand, liquidate his cash or securities position." *Guy D. Marianette,* 11 SEC 967, 971 (1942). Hence, the broker-dealer is required to file reports which are subject to such examination as the SEC may deem necessary or appropriate in the public interest or for the protection of investors. As the majority points out, a principal and, in fact, dominant method of investor protection is the net capital rule. Section 15(c)(3) of the '34 Act, 15 U.S.C. § 78o(c)(3), authorizes the SEC to provide safeguards with respect to the financial responsibility of broker-dealers including their "acceptance of custody and use of customers' securities, and the carrying and use of customers' deposits or credit balances." Pursuant to Rule 15c(3)(1)(b)(2), 17 C.F.R. § 240.15c3-1(b)(2), the SEC exempts broker-dealers who are members in good standing of the New York Stock Exchange (as was Weis) from compliance with SEC net capital requirments. This is because such broker-dealers are subjet to Exchange Rule 325, which is deemed by the Commission to impose requirements more comprehensive than the requirements of the SEC. Id. Under Rule 325 Weis was required to maintain a minimum prescribed ratio of aggregate indebtedness to net capital. Compliance by broker-dealers with the net capital rule is ensured by the filing of reports and monitoring by SEC as well as by the Exchange, which is authorized to enforce its regulations, see 15 U.S.C. § 78(f) and which, according to the SEC brief submitted on this appeal, makes annual examinations of each of its broker-dealer members to this end.

Congressional concern for the solvency of broker-dealers was not limited to the reporting and monitoring requirements of section 17. Following the boom of the

1960's a number of brokerage firms experienced financial instability and even failure. *Securities Investor Protection Corp.* v. *Barbour, supra,* at 415. The response of Congress was the enactment in 1970 of the Securities Investor Protection Act (SIPA), 15 U.S.C. §78aaa *et seq.* as an amendment to the '34 Act. Under SIPA Congress created the Securities Investor Protection Corporation (SIPC), the function of which extends well beyond providing protection to investors upon the liquidation of their brokers. As the Court noted in *Securities Investor Protection Corp.* v. *Barbour, supra,* at 421:

> The SIPC properly treats an application for the appointment of a receiver and liquidation of a brokerage firm as a last resort. It maintains an early-warning system and monitors the affairs of any firm that it is given reason to believe may be in danger of failure.

The SEC too has noted that the primary purpose of the net capital requirements for broker-dealers is to give "the [SEC], self-regulators and SIPC sufficient early warning to take appropriate action to protect customers prior to the time . . . of liquidation." 1934 Act Release No. 11497, June 26, 1975 [1975-76 Transfer Binder], CCH Fed. Sec. L. Rep. ¶80,212.

The majority here finds that since section 18(a) leaves broker-dealer customers without protection and since brokers' customers are the "favored wards" of section 17, it cannot agree that Congress simultaneously sought to protect them and to deprive the class of the means of protection. However, a review of section 17(a) and the rules promulgated by the SEC as well as the creation of SIPC, demonstrates that the means Congress employed to ensure solvency of broker-dealers were to require the keeping and filing of records, the maintenance of certain net capital balances and the oversight of

the SEC, SIPC and the Exchanges. Thus, the primary congressional intent obviously has been to provide a system of reports and monitoring which would *prevent* insolvency of broker-dealers; not to create private law suits for damages *after* insolvency has occurred.[7]

Since the filing requirements of section 17(a) are designed to give early warning, the importance to this scheme of implying a damage remedy *after* liquidation is dubious. Congress made no suggestion either in 1934 or in 1970, when it enacted SIPA, that a private damage action was a *necessary* corollary of the section 17(a) reporting provisions. The threat of liquidation under SIPA as well as the criminal sanctions available for violations of section 17(a) certainly present a greater deterrent than private damage actions.[8] As the Supreme Court noted in *Piper,* "Nor can we agree that an ever-present threat of damages [beyond available injunctive relief] . . . will provide significant additional protection. . . . The deterrent value, if any, of such awards can never be ascertained with precision." 430 U.S. at 39-40.

Even more importantly, to the extent that a threat of private damage actions might further induce compliance with the reporting scheme of section 17 the majority has discounted the effect of available state law remedies, which arise not from state securities law protection of brokers' customers, but from well established tort law

[7]In fact SIPC's preventive measures have been quite successful. The vast majority of firms brought to SIPC's attention have been deterred from the necessity of undergoing a SIPC liquidation through a variety of tactics including mergers and withdrawal from the business of carrying customer accounts. See *Securities Investor Protection Corp.* v. *Barbour, supra,* at 421 n.4.

[8]For example, in the instant situation the SEC initiated an action for injunctive relief against Weis and its officers. *SEC* v. *Weis Securities, Inc.,* 73 Civ. 2332 (S.D.N.Y.). A number of Weis' principals were also convicted of a criminal conspiracy to falsify Weis' books of account. See *Rich* v. *Touche Ross & Co., supra,* 415 F.Supp. at 101.

principles.[9] See, e.g., Restatement 2d of Torts §§ 531,552 (1977). Common law actions for damages against accountants have long been recognized. See, e.g., Note, Accountants' Liabilities For False and Misleading Financial Statements, 67 Colum. L. Rev. 1437 (1967). Where, as in the instant case, fraud is arguably alleged, it is important to note that should the actionable elements of fraud be provable, the states have universally permitted recovery to third parties who relied on the misrepresentations. Anno.: Liability of Public Accountant to Third Parties, 46 A.L.R. 3d 979, 982-83 (1972). While the state law treatment of actions based only on an accountant's negligence has not been so uniform, id. at 982, the trend in state law, based on generally recognized tort principles, has been to expand the accountant's liability for negligence to those clearly definable classes of third parties who the accountant knew would rely on the statements in question. See, e.g., *White* v. *Guarente,* 43 N.Y.2d 356, 401 N.Y.S.2d 474 (1977); Restatements 2d of Torts § 552 (1977). In fact, should scienter be held a required element of the action found implied by the majority in section 17,[10] see *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185 (1976), it may well be that a state law action would provide a broader basis for accountant liability than the federal action implied here under the '34 Act.

In any event, the very existence of these state law remedies supplies that threat of liability which the majority essentially is seeking in order to promote adherence to the requirements under section 17(a).

[9]The same cannot be said of the appellants herein. In addition to the state law class action against Touche Ross which has been filed by Weis' customers in the Supreme Court of New York County, see *Rich v. Touche Ross & Co., supra,* 415 F.Supp. at 104, the appellants have initiated a state law action based on the same common law claims set forth in their complaint in this federal action. *Redington* v. *Touche Ross & Co.,* No. 13996/76 (Sup. Ct. N.Y. Co.).

[10]The point was reached neither by the majority here nor by Judge Wyatt below.

Thus, the majority wrongly dismisses the significance of availiable state law remedies on the ground that the standard of liability for private damage actions in connection with 17(a) violations must be national in scope. Since, as demonstrated above, the *primary* congressional purpose underlying the section 17 reporting scheme is prophylactic, uniformity of standards for actions brought to recover losses *after* the brokerage firm has failed simply is not *necessary* to achieving the primary goals of that statute. See *Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 477-78 (1977).

The SEC has also argued, and the majority has accepted the position, that private damage actions are a necessary supplement to commission action because the SEC does not have the resources to audit the financial statements submitted under section 17(a). Whatever force this argument might once have had, see *J. I. Case Co.* v. *Borak, supra,* 377 U.S. at 432, is seriously undermined by the Court's observation in *Piper* that "institutional limitations alone do not lead to the conclusion that any party . . . should have a cause of action for damages." 430 U.S. at 41. The argument that a regulatory agency is confessedly unable properly to regulate broker-dealers as charged by Congress and detailed by its own regulations, and that therefore the federal courts should find a damage remedy implicit in an act which studiously avoided giving one to the class sought to be represented here, is simply unpersuasive.[11]

In sum, I conclude that since section 18(a) of the Act does provide a damage remedy for the filing of misleading statements in section 17(a) reports, and since this remedy excludes from its coverage the customers of

[11]The problem faced by the SEC in *Borak* of examining proxy statements under demanding time limitations (10 days or even 2 days, 17 C.F.R. §§ 240.14a-6(a), (b)), as pointed out by Judge Wyatt, 428 F. Supp. at 491, is not encountered here. Moreover, the SEC itself has stated that its burdens in this connection are lightened by the Exchange, which makes annual examinations of net capital statements by its members.

broker-dealers, the *Cort* factors employed by the majority afford an inappropriate analytical framework for this case. Instead, under the reasoning of *Amtrak* and *Barbour* it is apparent that by limiting actions under section 18(a) to purchasers and sellers of securities Congress expressed its intent to deny recovery for section 17(a) violations to a broader class of plaintiffs. Nor have the appellants here adduced the strong contrary evidence of legislative intent regarding section 17(a) which would lead me to reach the conclusion, embraced by the majority, that implication of such a remedy is consistent with the legislative scheme. Moreover, even if the *Cort* factors were the proper mode of analysis in this case, they must be applied in conjunction with the gloss of *Piper.* Yet there is no showing here that a private damage remedy against accountants is *necessary* to vindicate the primary congressional purpose embodied in section 17(a). As Judge Medina observed in *Lank* v. *New York Stock Exchange,* 548 F.2d 61, 65 (2d Cir. 1977) where we refused to imply a private remedy in favor of the SIPC receiver of an insolvent broker-dealer against the Exchange: "Even were we to agree . . . that granting him a right of action against the Exchange would 'accord' with the purpose of the [1934] Act, our function here is to discern the intent of Congress, not to legislate in its place."

III

Having found no implied cause of action arising under section 17(a) in favor of customers of broker-dealers, I could of course find no derivative rights in either SIPC or the trustee. However, I also contest the holding that appellants are proper parties to maintain the action found by the majority to be implied in section 17(a). The majority has properly held that neither the trustee nor SIPC in its own right can bring any action under section 17(a) of the '34 Act. Neither can claim to be an intended beneficiary of that act since both are the

creatures of SIPA, enacted in 1970. Nor is either appellant a public investor. *Lank* v. *New York Stock Exchange, supra,* 548 F.2d at 64-66 is dispositive of this issue.

Yet while denying to SIPC the right to bring a section 17(a) action on its own behalf, the majority also transmutes that entity into a subrogee clothed with the power in that capacity to bring a private damage action under 17(a) (an action itself now implied by the majority for the first time in the forty-four years section 17 has been on the books). By what alchemy a congressionally created corporation with limited powers to litigate, see *Securities Investor Protection Corp.* v. *Barbour, supra,* can now sue in a federal court for an alleged violation of section 17(a) of the '34 Act, is not made clear. When Congress created SIPC, its express but limited rights of subrogation were spelled out in SIPA: "To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section." 15 U.S.C. § 78fff(f)(1). As the majority recognizes, those claims to which SIPC is subrogated by statute are clearly against the debtor's estate only and no rights against the accountant flow therefrom. Since Congress has delineated the subrogation rights of SIPC, its failure to provide for subrogation against any third party would clearly dictate that none exist under the previously discussed principle: *expressio unius est exclusio alterius. Rogers* v. *National Surety Co.,* 116 Neb. 170, 216 N.W. 182 (1927). The effect of the majority's extension of SIPC's subrogation rights is to circumvent the intent of Congress by ignoring the directive of SIPA that SIPC be subrogated *"with the rights and priorities provided in this section."* 15 U.S.C. § 78fff(f)(1) (emphasis supplied).

Similarly, the Trustee, held by the majority to have no direct cause of action under section 17(a), is

nonetheless found to have such capacity in his role as a bailee. The majority finds that his responsibility to marshal and return property to the customers of the debtor broker-dealer authorizes him to bring this action. But that responsibility of the Trustee is created by SIPA, 15 U.S.C. § 78fff(a)(1), and is inherent in his Trustee function, see also 15 U.S.C. § 78fff(b)(1). Having rejected his right to sue as a Trustee of Weis under *Lank* v. *New York Stock Exchange, supra,* I fail to see how denominating him a bailee adds a jot or a tittle to his statutorily created status as the representative of Weis—an entity regulated by, and precluded from suing under, the Act. Furthermore, the customers on whose behalf the Trustee seeks to maintain suit are not only entitled to bring, but have already initiated their own action against Touche Ross. See notes, 3, 9, *supra.* The SEC understandably has expressed no view on this point.

For these reasons I respectfully dissent and would affirm Judge Wyatt's decision below.

Judgment of the Court of Appeals

United States Court of Appeals

FOR THE

SECOND CIRCUIT

At a stated Term of the United States Court of Appeals for the Second Circuit held at the United States Courthouse in the City of New York, on the twenty-first day of April one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS

Circuit Judges,

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

v.

TOUCHE ROSS & CO.,
Defendant-Appellee.

77-7183

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

ON CONSIDERATION WHEREOF, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed and the action be and it hereby is remanded to said district court for further proceedings in accordance with the opinion of this court with costs to be taxed against the appellee.

A. DANIEL FUSARO,
Clerk

By ARTHUR HELLER,
Deputy Clerk

Order Denying Petition For Rehearing

United States Court of Appeals

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of July, one thousand nine hundred and seventy-eight.

Present:

HON. J. EDWARD LUMBARD
HON. WILLIAM H. MULLIGAN
HON. WILLIAM H. TIMBERS

Circuit Judges.

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

vs.

TOUCHE ROSS & Co.,
Defendant-Appellee.

Docket No. 77-7183

A petition for a rehearing having been filed herein by counsel for the appellee, Touche Ross & Co.

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED

A. DANIEL FUSARO,
Clerk

Order Denying Rehearing En Banc

United States Court of Appeals

SECOND CIRCUIT

At a stated term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the seventh day of July, one thousand nine hundred and seventy-eight.

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs-Appellants,

v.

TOUCHE ROSS & Co.,
Defendant-Appellee.

Docket No. 77-7183

A petition for rehearing containing a suggestion that the action be reheard en banc having been filed herein by counsel for the appellee, Touche Ross & Co., and no active judge or judge who was a member of the panel having requested that a vote be taken on said suggestion.

Upon consideration thereof, it is Ordered that said petition be and it hereby is DENIED.

IRVING R. KAUFMAN
Irving R. Kaufman,
Chief Judge

[428 F. Supp. 483]

Opinion of the District Court

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

[March 1, 1977]

EDWARD S. REDINGTON, as Trustee for the liquidation of the business of Weis Securities, Inc., and SECURITIES INVESTOR PROTECTION CORPORATION,
Plaintiffs,

—against—

TOUCHE ROSS & Co.,
Defendant.

76 Civ. 1981

APPEARANCES:

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[428 F. Supp. 485]

WYATT, District Judge.

This is a motion by defendant Touche Ross & Co. (Touche) to dismiss the complaint pursuant to Rule 12(b) of the Federal Rules of Civil Procedure, on two grounds: that the Court lacks subject matter jurisdiction, and that the complaint fails to state a claim upon which relief can be granted; in the alternative, it is sought to stay this

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action pending determination of an action between the same parties in the New York Supreme Court, New York County.

1.

Weis Securities, Inc. (Weis), was a large stock brokerage house. Weis was a broker-dealer registered with the Securities and Exchange Commission (SEC) and was a member of the New York Stock Exchange and of other stock exchanges. Weis is said to be a corporation, although where incorporated does not appear; its principal place of business is said to have been in the City of New York.

Touche is a firm of certified public accountants and acted as such for Weis.

In May 1973, Securities Investor Protection Corporation (SIPC) applied to this Court for a decree adjudicating, under the Securities Investor Protection Act of 1970 (15 U.S.C. §§ 78aaa and following; "SIPA"), that customers of Weis were in need of protection under SIPA, appointing a trustee for the liquidation of Weis, and affording other relief. This Court granted the application and appointed Edward S. Redington as Trustee (referred to usually as the "Trustee"). The proceedings in which the Trustee was appointed are described in *Exchange National Bank v. Wyatt,* 517 F.2d 453 (2d Cir. 1975). The Trustee was appointed on May 30, 1973; the "filing date" (15 U.S.C. § 78eee(b)(4)(B)) was May 24, 1973. Weis has since been in liquidation under SIPA.

2.

On July 3, 1975, the Trustee and SIPC commenced an action against Touche in New York Supreme Court, New York County (Index No. 13996/76; the action has a 1976 number because the first paper filed in the action was in 1976). The causes of action of each plaintiff were separately stated but there were in the complaint 21 paragraphs of "common allegations" which were then incorporated by reference in each claim of the Trustee and in each claim of SIPC. There were five causes of action by the Trustee and four causes of action by SIPC.

3.

The case at bar was commenced in this Court on April 30, 1976. The parties are the same as those in the State action. The Trustee and SIPC are again suing Touche.

The complaint in the case at bar asserts exactly the same claims as in the State action and adds claims by the Trustee and SIPC based on alleged violations by Touche

of the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a and following; "the 1934 Act"), specifically of Section 17 of the 1934 Act (15 U.S.C. § 78q).

The "common allegations" are the same in both actions except that three paragraphs have been added here to shore up the added Section 17 claims of the Trustee and SIPC.

In this action, there are 6 claims by the Trustee and 8 claims by SIPC. (The claims are mistakenly called causes of action in the complaint, ignoring Fed.R.Civ.P. 8 and following the nomenclature in the State courts.)

The two plaintiffs have joined as such (presumably under Fed.R.Civ.P. 20(a) and properly) but their claims are several, not joint, and are stated in separate counts.

Counts two through six of the complaint in the case at bar are exactly the same as the five causes of action of the Trustee in the State action. Count one in the case at bar is the added claim under Section 17 of the 1934 Act.

The first four claims of SIPC in the case at bar are not in the State Action and are apparently intended to be based on Section 17 of the 1934 Act although in the first four counts there is no express reference to Section 17 (except as paragraphs 1, 16, 17, 21, and 22 of the complaint are incorporated by reference in these counts). The other four SIPC claims in the case at bar are exactly the same as the four SIPC causes of action in the State action.

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4.

The claims in the case at bar are alleged to arise under the 1934 Act and particularly under Section 17 thereof (15 U.S.C. § 78q), under Section 6 of SIPA (15 U.S.C. § 78fff), and under the common law (complaint, para 1).

The complaint avers that the Court has jurisdiction over the claims of the Trustee under Section 27 of the 1934 Act and under 28 U.S.C. § 1331. It further avers (in effect) that the Court has jurisdiction in bankruptcy by virtue of Section 6 of SIPA (15 U.S.C. § 78fff), under Sections 2a(7), 102 and 115 of the Bankruptcy Act (11 U.S.C. §§ 11a(7), 502 and 515), and under 28 U.S.C. § 1334. The complaint also avers jurisdiction over the common law claims of the Trustee under principles of pendent jurisdiction (complaint, para 2).

Jurisdiction over SIPC's claims is alleged to exist under Section 27 of the 1934 Act and 28 U.S.C. § 1331, under the diversity of citizenship statute (28 U.S.C. § 1332) and under principles of pendent jurisdiction (complaint, para 3).

There then follows a series of "Common Allegations" comprising 24 paragraphs of the complaint which are incorporated by reference in both the six counts pleaded by the Trustee and the eight counts pleaded by SIPC.

The complaint avers that five of Weis' officers misstated the financial condition and results of operation of Weis in financial reports prepared at the end of fiscal year 1972, and that such reports were required to be filed with regulatory authorities pursuant to Section 17 of the 1934 Act. It alleges that these reports were directly or indirectly submitted to Weis, its Board of Directors, the SEC, SIPC, the Exchange, and Weis' customers, creditors, lenders and shareholders.

Plaintiffs aver that Touche breached duties it assumed toward them under Section 17 of the 1934 Act and under the common law when it became Weis' auditor and undertook to perform all necessary auditing and accounting services needed to audit the reports of financial condition that Weis was required to submit to the SEC. Essentially, these "common allegations" charge Touche with negligence and recklessness in the performance of its services (para 28); SIPC argues that they also

charge wilful misconduct (Memorandum of Plaintiff SIPC in Opposition to Defendant's Motion to Dismiss, p. 5). The complaint also alleges that Touche falsely certified that it had performed the necessary services and made false representations with respect to the Answers to Financial Questionnaire and other documents dated May 26, 1972. The "common allegations" then state that because of these failures and misrepresentations of Touche, the Exchange, the SEC and SIPC were prevented from knowing the true condition of Weis, and were prevented from acting to safeguard the assets of Weis and the property held by Weis for its customers; and that Weis continued to undertake financial obligations which it could not satisfy. As a result of the failure to act of the regulatory authorities, the liquidation of Weis became necessary when the facts were discovered. This was after the Weis assets and the property held by it for customers had been further depleted, and when it was too late to take remedial action. Upon liquidation, SIPC was required under SIPA to provide the Trustee with funds for the payment of claims submitted by customers and "certain other creditors" of Weis.

Paragraphs 32-49 of the complaint state six claims by the Trustee against Touche. The first claim charges that Touche violated, and aided and abetted the Weis officers in violating, Section 17 of the 1934 Act and the rules and regulations promulgated thereunder, which require broker-dealers (such as Weis) to file accurate reports of their financial condition, including reports such as those certified by Touche. It further states (para 34) that "Weis, its Board of Directors, its creditors, customers, lenders and shareholders were among the ciass of persons which Section 17 of the 1934 Act was designed to protect and were among the beneficiaries of duties imposed on Touche Ross by Section 17 of the 1934

Act",

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and that the injuries which occurred as a result of the liquidation of Weis were of the type that Section 17 was intended to prevent.

The Trustee's other five claims state that Touche breached duties to Weis under the common law of New York. The second claim charges Touche with negligence per se in violating Section 17 of the 1934 Act. The third charges Touche with negligence and malpractice. The fourth charges Touche with recklessness and gross negligence. The Trustee's fifth claim charges breach of contract. The sixth claim charges breach of express and implied warranties that Touche would comply with generally accepted auditing standards, generally accepted accounting principles, and the audit regulations of the Exchange and the SEC.

In paragraphs 52-85 of the complaint, SIPC alleges eight claims against Touche, four on its own behalf and four on behalf of Weis' customers and certain other creditors. The first four claims allege violations of Section 17 of the 1934 Act and the others allege violations of the common law.

SIPC's first claim is under Section 17 of the 1934 Act and charges that Touche failed to comply with the auditing standards and regulations prescribed by the 1934 Act and the rules promulgated thereunder in that opinion letters, answers to the financial questionnaire and financial statements prepared by Touche were false, inaccurate and incomplete, and that as a consequence the SIPC fund has been depleted in order to satisfy the claims of 34,000 customers and other creditors. Its third claim (also under Section 17) charges that Touche had knowledge, or, but for its errors and omissions, would have had knowledge, of the deceptions caused by the Weis officers in violation of the 1934 Act and that Touche aided and abetted the Weis officers in this

deception. The fifth claim (under common law) charges Touche with negligence and malpractice. The seventh claim (under common law) charges Touche with recklessness and gross negligence. SIPC's second, fourth, sixth and eighth claims are the same respectively as the first, third, fifth and seventh claims above described except that the second, fourth, sixth and eighth claims aver that Touche violated duties to the customers and certain other creditors of Weis and that SIPC is subrogated to the claims which such customers and other creditors could have asserted, this because SIPC has compensated them out of the SIPC fund.

5.

As seen above, the Trustee's first claim and the first, second, third, and fourth claims of SIPC are asserted under Section 17 of the 1934 Act (15 U.S.C. § 78q).

The argument for Touche is that there is no provision in Section 17 for a private right of action (as, for example, there is in Section 16) and that no private right of action is maintainable under Section 17.

The argument for plaintiffs is that, while no private right of action is expressly provided for in Section 17, a right of action should be implied for parties such as SIPC, the Trustee and customers and creditors of Weis who are said to fall within the "class for whose *especial* benefit the statute was enacted", citing *Cort* v. *Ash*, 422 U.S. 66, 78, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975; emphasis in original), which quoted from *Texas & P.R. Co.* v. *Rigsby*, 241 U.S. 33, 39, 36 S.Ct. 482, 60 L.Ed. 874 (1916).

6.

If there were any violations by Touche of Section 17, they occurred in 1972. Since then, there have been extensive amendments (in 1975) to Section 17 but in 1972 the relevant part of Section 17 read as follows:

> "Every national securities exchange, every member thereof, every broker or dealer who trans-

acts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 78o of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other

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records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

From the wording of this provision and in the context of the other provisions of the 1934 Act, it would appear that Section 17 was designed to supply administrative guidance in the bookkeeping area and not to create any rights in anybody. Section 17 has also been used as authority for the inspection program of the SEC, which is somewhat like the inspection work of the bank examiners.

In the 43 years during which the statute has been on the books, there has been no decision whether a private right of action can be asserted for a violation of Section 17. The Supreme Court, about a year ago, refused to consider whether there was such a private cause of action. *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 194 fn. 13, 96 S.Ct. 1375, 47 L.Ed.2d 668 (1976).

There is nothing explicit to show any legislative intent respecting a private claim under Section 17.

The section, however, is entitled "Accounts and records, reports . . . ." and the very next section is entitled "Liability for misleading statements". This next section, Section 18 (15 U.S.C. § 78r), creates a private cause of action for "misleading statements" in "any application, report, or document filed pursuant to this chapter . . . " in favor of any person who purchased or sold a security at a price affected by the misleading statements. The subject matter of the two sections, their titles, and their juxtaposition would strongly suggest a legislative intent that the *only* private claim for a violation of Section 17 was the claim created in Section 18. Plaintiffs here are obliged to argue that there is an implied private claim under Section 17 *broader* than the claim *expressly* created by Section 18. This is because they did not purchase nor sell any security "at a price affected . . . " etc., and thus cannot state a claim under Section 18. In this connection, it may be well to recall the words of the Supreme Court in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 736, 95 S.Ct. 1917, 1925, 44 L.Ed.2d 539 (1975):

> "Section 18 of the 1934 Act, prohibiting false or misleading statements in reports or other documents required to be filed by the 1934 Act, limits the express remedy provided for its violation to 'any person . . . who . . . shall have purchased or sold a security at a price which was affected by such statement . . . '. It would indeed be anomalous to impute to Congress an intention to expand the plaintiff class for a judicially implied cause of action beyond the bounds it delineated for comparable express causes of action."

Sections 13(a) and 13(d) of the 1934 Act (15 U.S.C. § 78m(a) and (d)) require the filing of specified reports by issuers and the filing of reports by those who acquire more than 5% of a registered equity security. Claims have been asserted under this Section by those who were not purchasers or sellers of any security and who thus could not state a claim under Section 18. They asked the Courts, as the plaintiffs do here, to imply a private right of action from the section alleged to have been violated. The Courts have declined to do so, holding that Section 18 is the only civil liability provision for a violation of the "reporting provisions" of the 1934 Act. *Meer* v. *United Brands Co.*, CCH Fed.Sec.L.Rep. ¶ 95,648 (S.D.N.Y. July 6, 1976; Carter, J.); *Myers* v. *American Leisure Time Enterprises*, 402 F.Supp. 213 (S.D.N.Y. 1975; Weinfeld, J.), affirmed without opinion 538 F.2d 312 (2d Cir. 1976); *In re Penn Central Securities Litigation*, 347 F.Supp. 1327, 1340 (E.D.Pa. 1972), affirmed 494 F.2d 528 (3d Cir. 1974).

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In *In re Penn Central Securities Litigation*, cited above, the District Court stated (347 F.Supp. at 1340):

> "Section 13 is one of a number of provisions that require the filing of applications, documents and reports. See §§ 12(b), 12(g), 15(b)(1), 15A(a), 16(a) and 17(a). Section 18(a) is the 'catch-all' civil liability provision for all of the reporting requirements of the Exchange Act, and we conclude that it is the exclusive remedy for violation of § 13(a)."

Opposed to the suggestion that the only protection intended for a violation of Section 17 was the liability created in Section 18, is the argument that customers of brokers and dealers in their dealings with such brokers

and dealers can never rely on the relief provided by Section 18 because in such dealings they can never meet the purchaser-seller requirement of that section. Section 17, runs the argument, was intended to protect those who choose to leave securities they have purchased, or cash resulting from securities they have sold, with their broker. Section 17's purpose is to protect these people by requiring their brokers to file reports with the SEC so that the SEC (and now SIPC as well) might police their activities so as to ensure the solvency of brokers.

Although Section 18 might not, of itself, foreclose the implication of a private right of action under Section 17, this does not mean that Section 18 is irrelevant to the question here.

It should be noted that when Congress wanted to create private causes of action for violations of provisions of the 1934 Act, it knew how to do it and did do it. In addition to the "reporting" violations made the subject of private rights of action in Section 18, Congress specifically provided for civil liability in Section 9(e) (15 U.S.C. § 78i(e)) and Section 16(b) (15 U.S.C. § 78p(b)) of the 1934 Act. Congress also provided for "liabilities of controlling persons" in Section 20 of the 1934 Act (15 U.S.C. § 78t).

Nor is it necessary to imply a civil liability under Section 17 in order to enforce its provisions. There can be a criminal prosecution. *United States* v. *Sloan*, 389 F.Supp. 526 (S.D.N.Y. 1975). The SEC can secure an injunction where a violation is proved of Section 17, described by Judge Tenney as "the bookkeeping rule". *SEC* v. *Resch-Cassin & Co., Inc.*, 362 F.Supp. 964, 979 (S.D.N.Y. 1973).

It remains to consider *J. I. Case Company* v. *Borak*, 377 U.S. 428, 84 S.Ct. 1555, 12 L.Ed.2d 423 (1964) on which plaintiffs properly rely. In *Borak* a private right of action was implied for a violation of Section 14(a) of the

1934 Act (15 U.S.C. § 78n(a)) despite the lack of any provision therein for a private right of action and despite the existence of the civil liability provision in Section 18 (15 U.S.C. § 78r).

Borak was a suit by a stockholder of Case, the management of which solicited proxies for voting in favor of a merger of Case with another corporation. It was alleged that the proxy solicitation material was false and was in violation of Section 14(a) of the 1934 Act; that the merger would not have been approved by stockholders were it not for the false and misleading statements; and that the stockholders of Case had been damaged.

Section 14(a), together with an SEC Rule prescribed thereunder, makes it unlawful to solicit proxies by means of a proxy statement to stockholders containing false or misleading statements.

There is nothing in the statute which requires any filing with the SEC of proxy statements or other soliciting material. But the regulations of the SEC under Section 14(a) require that "preliminary copies" of the proxy statement or other soliciting material be filed with the SEC, as well as "definitive copies". 17 CFR § 240.14a-6

Soliciting material is plainly intended for the information of the stockholders, not of the SEC. The SEC has only an oversight or policing function.

In *Borak* a private right of action was implied because plaintiff, one of the stockholders solicited, was of the class intended to be protected by the statute; and because

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such private action was a "necessary supplement to Commission action" (377 U.S. at 432, 84 S.Ct. 1555) since the SEC had not the time for an "independent examination" of the soliciting material filed with it (377 U.S. at 432, 84 S.Ct. 1555).

But the case at bar is not like *Borak*. The reports required by Section 17 in 1972 were not for the information of any "investors" and were not sent to them but were for the SEC, primarily for monitoring the net capital requirements of the 1934 Act (Section 8(b); 15 U.S.C. § 78h(b)). Moreover, in examining the records and reports made under Section 17(a) the SEC does not have the time limitations applicable to the *Borak* proxy statements (ten days in some cases (17 CFR § 240.14a-6(a)) and two days in others (17 CFR § 240.14a-6(b)). The SEC has an inspection program, similar to that of bank examinations. It is not "necessary" to enforce Section 17 by private actions; criminal prosecutions and SEC injunctive actions seem abundantly sufficient. If, as is the case, the record keeping requirements of Section 17 are to give early warning to the SEC of financial difficulties of a broker and thus avoid liquidation, it cannot help to imply a private right of action *after* liquidation has become a fact.

The Supreme Court has refused to expand the *Borak* principle; indeed, the Court has restricted it.

In *Cort v. Ash*, 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975), the Supreme Court refused to imply a private right of action for a violation of 18 U.S.C. § 610. The Court referred to *Borak* as an instance where there was "a pervasive legislative scheme governing the relationship between the plaintiff class and the defendant class in a particular regard" (422 U.S. at 82, 95 S.Ct. at 2090). There is no such "pervasive legislative scheme" in the case at bar.

And only last week, the Supreme Court, reversing our Court of Appeals, declined to imply a private right of action under Section 14(e) of the 1934 Act. *Piper* v. *Chris-Craft Industries, Inc.*, ____ U.S. ____, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977).

The test was whether "the creation by judicial interpretation of the implied cause of action . . . is *necessary* to effectuate Congress' goals" (emphasis supplied). This test has already been applied here and no such implication found "necessary".

The Supreme Court determined that plaintiff in *Chris-Craft* was not an intended beneficiary of the legislation. Here, neither the Trustee nor SIPC could possibly have been meant to be protected by Section 17, if for no other reason because the SIPA legislation was not passed until more than thirty years after Section 17. Additionally, neither the Trustee nor SIPC is an investor.

The case of *Lank* v. *The New York Stock Exchange*, 548 F.2d 61 (2d Cir. 1977), is instructive in this respect. There our Court of Appeals refused to imply a private right of action in the receiver of a member of the Exchange under Section 6 of the 1934 Act. The Court emphasized that brokers were not investors to be protected by the 1934 Act and that Section 6 was not enacted "for the purpose of affording protection to the very members of the stock exchanges whose conduct was being regulated . . . ". This analysis seems applicable to the plaintiffs in the case at bar.

Finally, Section 17 does not impose any duty on accountants. It specifically mentions a "national securities exchange", the members thereof, a "registered securities association", brokers, and dealers; it does not mention accountants. While the regulations do contain provisions respecting an accountant's certificate (17 CFR § 240.-17a-5(f)(g)(h)(i)), the oath is only by the broker or dealer (17 CFR § 240.17a-5(b)(2)). Judge Weinfeld discussed the problem in *Rothstein* v. *Seidman & Seidman*, 410 F.Supp. 244 (S.D.N.Y.1976) where he emphasized that a "special instruction" of the New York Stock Exchange laid a duty on its members but not on their accountants.

It is concluded that the Trustee's first claim and the first, second, third, and fourth claims of SIPC must be dismissed for failure to state a claim upon which relief can be granted.

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7.

The other five claims of the Trustee are common law claims. The question is whether this Court has any jurisdiction of them. It seems clear that this Court has no jurisdiction.

Pendent jurisdiction will not justify retention of these claims. The federal claim of the Trustee in count one has been dismissed before trial and we are instructed that, in such event, "the State claims should be dismissed as well". *United Mine Workers* v. *Gibbs*, 383 U.S. 715, 726, 86 S. Ct. 1130, 16 L.Ed.2d 218 (1966)

The Trustee asserts an independent basis for jurisdiction under the general language of 11 U.S.C. § 11(a)(7).

The situation at bar, however, is controlled by 11 U.S.C. § 46 which provides that a trustee in bankruptcy may sue only in the courts where the bankrupt might have sued.

Section 6(c)(1) of SIPA (15 U.S.C. § 78fff(c)(1)) states in relevant part:

> "Except as inconsistent with the provisions of this chapter and except that in no event shall a plan of reorganization be formulated, a liquidation proceeding shall be conducted in accordance with, and as though it were being conducted under, the provisions of Chapter X and such of the provisions . . . of chapters I to VII, inclusive, of the Bankruptcy Act as section 502 of Title 11 would make applicable if an order of the court

had been entered directing that bankruptcy be proceeded with pursuant to the provisions of such chapters I to VII, inclusive . . .".

Section 502 of Title 11 states in relevant part:

> "The provisions of chapters 1 to 7, inclusive of this title shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 46 . . . shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters 1 to 7, inclusive." (emphasis in original)

Thus Section 46 of Title 11 is applicable to SIPA liquidations.

The arguments for the Trustee have been considered but cannot be accepted.

It may be mentioned that the Trustee urges a consent by Touche to the jurisdiction of this Court, a consent said to flow from the filing by Touche of a claim for professional services in the Weis liquidation. But the claim filed by Touche in the Weis liquidation was for accounting work in *European offices of Weis* in late 1972 and early 1973, as well as for a Stock Exchange audit as of April 27, 1973. The claim by the Trustee against Touche does not arise out of any work done for Weis by Touche and for which Touche filed a claim in the Weis liquidation. The claims are not "mutual" therefore but are unrelated and the consent of Touche cannot be found. *Cherno* v. *Engine Air Service, Inc.*, 330 F.2d 191 (2d Cir. 1964).

Under 11 U.S.C. § 46 we look to see whether Weis could have sued Touche in this Court. It seems undisputed that the principal place of business of Weis (28

U.S.C. § 1332(c)) was in New York and that members of the Touche firm are citizens of New York. Diversity jurisdiction would not exist of an action by Weis against Touche.

The second, third, fourth, fifth and sixth claims of the Trustee must be dismissed for lack of jurisdiction over the subject matter.

8.

The fifth, sixth, seventh, and eighth claims of SIPC are common law claims. As to these, SIPC argues for diversity jurisdiction on the ground that it should be considered for diversity purposes as a District of Columbia corporation. This argument cannot be accepted.

Under SIPA, SIPC was created as a corporation but it distinctly was *not* made a District of Columbia corporation. The relevant part of SIPA (15 U.S.C. § 78ccc(a)(3)) provides that SIPC is "subject

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to" the District of Columbia Nonprofit Corporation Act and has "all the powers" conferred on a nonprofit corporation by that Act. This does not mean, however, that it *is* a District of Columbia corporation. Note should be taken of the Act of Congress creating The American National Red Cross. Named persons are created "a body corporate and politic in the District of Columbia" (36 U.S.C. § 1a). For diversity purposes, the Red Cross is a citizen of the District of Columbia because the statutory language is specific, in marked contrast to that in SIPA. *Patterson* v. *Amer. Nat. Red Cross*, 101 F. Supp. 655 (S. D. Fla. 1951).

SIPC appears to be a federally created corporation which, like the American Legion (36 U.S.C. § 41), the

Disabled American Veterans (36 U.S.C. § 90a) and others, is not a citizen of any state for jurisdictional purposes. *Hancock Financial Corp.* v. *Federal Savings, etc.*, 492 F.2d 1325 (9th Cir. 1974); *Rice* v. *Disabled American Veterans*, 295 F. Supp. 131 (D. C. D. 1968).

There can be no jurisdiction simply because SIPC was created by Act of Congress because there is no stock ownership in SIPC by the United States. 28 U.S.C. § 1349.

Finally, the Trustee is a citizen of New York and is a plaintiff along with SIPC. Partners of Touche, the defendant, are citizens of New York. Thus, there is no complete diversity of citizenship within the rule of *Strawbridge* v. *Curtiss*, 3 Cranch 267, 2 L.Ed. 435 (1806).

The fifth, sixth, seventh, and eighth claims of SIPC must be dismissed for lack of jurisdiction over the subject matter.

Settle order and judgment on notice.

Dated: New York, New York
March 1, 1977

INZER B. WYATT
United States District Judge

STATUTES AND RULES

Securities Exchange Act of 1934

Section 17(a), 15 U.S.C. § 78q(a), as in effect prior to the Securities Acts Amendments of 1975, Pub. L. 94-29 (June 4, 1975):

"Accounts and Records, Reports, Examinations of Exchanges, Members, and Others

"SECTION 17. (a) Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities through the medium of any such member, every registered securities association, and every broker or dealer registered pursuant to section 15 of this title, shall make, keep, and preserve for such periods, such accounts, correspondence, memoranda, papers, books, and other records, and make such reports, as the Commission by its rules and regulations may prescribe as necessary or appropriate in the public interest or for the protection of investors. Such accounts, correspondence, memoranda, papers, books, and other records shall be subject at any time or from time to time to such reasonable periodic, special, or other examinations by examiners or other representatives of the Commission as the Commission may deem necessary or appropriate in the public interest or for the protection of investors."

Section 18(a), 15 U.S.C. § 78r(a):

"Liability for Misleading Statements

"SECTION 18. (a) Any person who shall make or cause to be made any statement in any application, report, or document filed pursuant to this title or any rule or regulation thereunder or any undertaking contained in a registration state-

ment as provided in subsection (d) of section 15 of this title, which statement was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, shall be liable to any person (not knowing that such statement was false or misleading) who, in reliance upon such statement, shall have purchased or sold a security at a price which was affected by such statement, for damages caused by such reliance, unless the person sued shall prove that he acted in good faith and had no knowledge that such statement was false or misleading. A person seeking to enforce such liability may sue at law or in equity in any court of competent jurisidiction. In any such suit the court may, in its discretion, require an undertaking for the payment of the costs of such suit, and assess reasonable costs, including reasonable attorneys' fees, against either party litigant."

Securities Investor Protection Act of 1970

Section 6(b)(1), 15 U.S.C. § 78fff(b)(1):

"(1) Trustee powers.—A trustee appointed under section 5(b)(3) (hereinafter referred to as "trustee") shall be vested with the same powers and title with respect to the debtor and the property of the debtor, and the same rights to avoid preferences, as a trustee in bankruptcy and a trustee under chapter X of the Bankruptcy Act have with respect to a bankrupt and a chapter X debtor. . . ."

Section 6(f)(1), 15 U.S.C. § 78fff(f)(1):

"(f) SIPC advances to trustee.—

(1) Advances for customers' claims.—In order to provide for prompt payment and satisfaction of the net equities of customers of debtor,

SIPC shall advance to the trustee such moneys as may be required to pay or otherwise satisfy claims in full of each customer, but not to exceed $50,000 for such customer; except that—

(A) insofar as all or any portion of the net equity of a customer is a claim for cash, as distinct from securities, the amount advanced by reason of such claim to cash shall not exceed $20,000;

(B) a customer who holds accounts with the debtor in separate capacities shall be deemed to be a different customer in each capacity;

(C) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy, directly or indirectly, any claims of any customer who is a general partner, officer, or director of the debtor, the beneficial owner of 5 per centum or more of any class of equity security of the debtor (other than a nonconvertible stock having fixed preferential dividend and liquidation rights) or limited partner with a participation of 5 per centum or more in the net assets or net profits of the debtor; and

(D) no such advance shall be made by SIPC to the trustee to pay or otherwise satisfy claims of any customer who is a broker or dealer or bank other than to the extent that it shall be established to the satisfaction of the trustee, from the books and records of the debtor or from the books and records of a broker or dealer or bank or otherwise, that claims of such broker or dealer or bank against the debtor arise out of transactions for customers of such broker or dealer or bank, in

which event, each such customer of such broker or dealer or bank shall be deemed a separate customer of the debtor.

"To the extent that moneys are advanced by SIPC to the trustee to pay the claims of customers, SIPC shall be subrogated to the claims of such customers with the rights and priorities provided in this section."

SEC Rules

Rule 17a-5, 17 C.F.R. § 240.17a-5, as in effect prior to SEC revisions of 1975, 40 F.R. 59712-17 (Dec. 30, 1975):

"§ 240.17a-5 Reports to be made by certain exchange members, brokers and dealers.

"(a) *Filing reports.* (1) This rule shall apply to every member of a national securities exchange who transacts a business in securities directly with or for others than members of a national securities exchange, every broker or dealer (other than a member) who transacts a business in securities through the medium of any member of a national securities exchange, and every broker or dealer registered pursuant to section 15 of the act.

(2) Every member, broker or dealer subject to this rule shall file reports of financial condition containing the information required by Form X-17A-5, as follows: (i) A report shall be filed as of a date within each calendar year, except that *(a)* the first such report of a member, broker or dealer (other than one succeeding to and continuing the business of another member, broker or dealer) shall be as of a date not less than one nor more than five months after the date on which such member, broker or dealer becomes subject

to this rule (in the case of a registered broker or dealer this shall be the date the registration becomes effective) and *(b)* a member, broker or dealer succeeding to and continuing the business of another member, broker or dealer need not file a report as of a date in the calendar year in which the succession occurs if the predecessor member, broker or dealer has filed a Form X-17A-5 report in compliance with this rule as of a date in such calendar year; (ii) such reports shall be filed not more than 45 days after the date of the report of financial condition; and (iii) reports for any two consecutive years shall not be as of dates within four months of each other. The reports provided for in this rule shall be filed in duplicate original with the Regional Office of the Commission for the region in which the member, broker or dealer has his or its principal place of business.

(b) *Nature and form of reports.* Each report of financial condition filed pursuant to paragraph (a) of this section shall be prepared and filed in accordance with the following requirements:

(1) The report of a member, broker or dealer shall be certified by a certified public accountant or a public accountant who shall be in fact independent: *Provided, however,* That such report need not be certified if, since the date of the previous financial statement or report filed pursuant to § 240.15b1-2 or this section, (i) said member has not transacted a business in securities directly with or for other than members of a national securities exchange; has not carried any margin account, credit balance or security for any person other than a general partner; and has not been required to file a certified financial statement with any national securities exchange; or (ii) his

or its securities business has been limited to acting as broker (agent) for the issuer in soliciting subscriptions for securities of such issuer, said broker has promptly transmitted to such issuer all funds and promptly delivered to the subscriber all securities received in connection therewith, and said broker has not otherwise held funds or securities for or owed money or securities to customers; or (iii) his or its securities business has been limited to buying and selling evidences of indebtedness secured by mortgage, deed of trust, or other lien upon real estate or leasehold interests, and said broker or dealer has not carried any margin account, credit balance, or security for any securities customer. A member, broker or dealer who files a report which is not certified shall include in the oath or affirmation required by paragraph (b) (2) of this section a statement of the facts and circumstances relied upon as a basis for exemption from the certification requirements.

(2) Attached to the report shall be an oath or affirmation that, to the best knowledge and belief of the person making such oath or affirmation, (i) the financial statement and supporting schedules are true and correct and (ii) neither the member, broker, or dealer, nor any partner, officer, or director, as the case may be has any proprietary interest in any account classified solely as that of a customer. The oath or affirmation shall be made before a person duly authorized to administer such oaths or affirmations. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner; or if a corporation, by a duly authorized officer

(3) If the schedules furnished pursuant to the requirements of items (a), (b), and (c) of part II

and the supplementary accountant's certificate furnished pursuant to the audit requirements of Form X-17A-5 are bound separately from the balance of the report, they shall be deemed confidential, except that they shall be available for official use by any official or employee of the United States or any State, by national securities exchanges and national securities associations of which the person filing such report is a member, and by any other person to whom the Commission authorizes disclosure of such information as being in the public interest. Nothing contained in this paragraph shall be deemed to be in derogation of the rules of any national securities association or national securities exchange which give to customers of a member, broker or dealer the right, upon request to such member, broker, or dealer, to obtain information relative to his financial condition.

(c) *Use of certain statements filed with the Securities and Exchange Commission, State Commissions and National Securities Exchanges.* (1) Any member, broker, or dealer who is subject to the provisions of paragraph (a) of this section may file in lieu of the report required by that paragraph a copy of any financial statement which he is, or has been, required to file with any national securities exchange of which he is a member, or with any agency of any State as a condition of doing business in securities therein, *Provided,* That (i) the copy so included reflects his financial condition as of a date not more than 45 days prior to the filing thereof with the Commission, and (ii) the report, as filed with this Commission, meets the requirements of this rule and Form X-17A-5 and contains the information called for by that form.

(2) At the request of any member, broker, or dealer who is (i) an investment company registered under the Investment Company Act of 1940, or (ii) a sponsor or depositor of such a registered investment company who effects transactions in securities only with, or on behalf of, such registered investment company, the Commission will accept any statement of his financial condition filed pursuant to sections 13 or 15(d) of the Securities Exchange Act of 1934 or section 30 of the Investment Company Act of 1940 and the rules and regulations promulgated thereunder as a filing pursuant to this rule. Such a filing shall be deemed to satisfy the requirements of this rule for any calendar year in which such a financial statement is filed, *Provided,* That the statement so filed meets the requirements of the other rules under which it is filed with respect to time of filing and content.

(d) *Extension of time for filing reports.* In the event any member, broker, or dealer finds that he cannot file his report for any year within the time specified in paragraph (a) or (c) of this section without undue hardship, he may file with the Commission an application for an extension of time to a specified date which shall not be more than 90 days after the date as of which his financial condition is reported. The application shall state the reasons for the requested extension and shall contain an agreement to file the report on or before the specified date. The application shall be deemed granted unless the Commission, within ten days after receipt thereof, enters an order denying the application.

(e) *Exemptions.* Any "bank", as defined in section 3(a)(6) of the Act (48 Stat. 882; 15 U.S.C. 78c) shall be exempt from the provisions of this section.

(f) *Qualifications of accountants.* The Commission will not recognize any person as a

certified public accountant who is not a duly registered and in good standing as such under the laws of his place of residence or principal office. The Commission will not recognize any person as a public accountant who is not in good standing and entitled to practice as such under the laws of the place of his residence or principal office.

(g) *Accountant's certificate*—(1) *Technical requirements.* The accountant's certificate shall be dated, shall be signed manually, and shall identify without detailed enumeration the items of the report covered by the certificate.

(2) *Representations as to audit.* The accountant's certificate (i) shall contain a reasonably comprehensive statement as to the scope of the audit made, including a statement as to whether the accountant reviewed the procedures followed for safeguarding the securities of customers, and including, if with respect to significant items in the report covered by the certificate any auditing procedures generally recognized as normal have been omitted, a specific designation of such procedures and of the reasons for their omission, (ii) shall state whether the audit was made in accordance with generally accepted auditing standards applicable in the circumstances; and (iii) shall state whether the audit made omitted any procedure deemed necessary by the accountant under the circumstances of the particular case.

(3) Nothing in this rule shall be construed to imply authority for the omission of any procedure which independent accountants would ordinarily employ in the course of an audit made for the purpose of expressing the opinions required by paragraph (h) of this section.

(h) *Accountant's certificate; options to be expressed.* The accountant's certificate shall state clearly the opinion of the accountant with respect to the financial statement covered by the certificate and the accounting principles and practices reflected therein.

(i) *Accountant's certificate; exceptions.* Any matters to which the accountant takes exception shall be clearly identified; the exception thereto shall be specifically and clearly stated; and, to the extent practicable, the effect of each such exception on the related item of the report shall be given.

(j)(1) If a broker or dealer holding any membership interest in and subject to the capital rules of a national securities exchange whose members are exempt from § 240.15c3-1 by paragraph (b)(2) thereof ceases to be a member in good standing of such exchange, such broker or dealer shall, within two business days after such event, file with the Commission, as of the date of such event:

(i) A proof of money balances of all ledger accounts in the form of a trial balance;

(ii) A computation of aggregate indebtedness and net capital made in accordance with § 240.15c3-1;

(iii) An analysis of the aggregate market value of fully paid securities in customers' security accounts not segregated showing the location of such securities;

(iv) Ledger net credit balances of money borrowed from banks, trust companies, and other financial institutions and from others, which are fully or partially secured by securities carried for the account of any customer, showing, for each

loan, an analysis of the market value of all collateral for such borrowings by source of collateral, stating separately the market value of: (*a*) Securities carried for the accounts of customers, (*b*) securities owned by the broker or dealer or by any general or special partner or any director or officer of such broker or dealer, and (*c*) any other securities, and

(v) The aggregate amount of customers' ledger debit balances.

The report shall be filed at the Commission's principal office in Washington, D. C., and in duplicate original with the Regional Office of the Commission for the region in which the broker or dealer has his or its principal place of business; *Provided, however,* That such report need not be made or filed if the Commission, upon written request or upon its own motion exempts such broker or dealer, either unconditionally or on specified terms and conditions, from such requirement; *Provided further,* That the Commission may, upon request of the broker or dealer, grant extensions of time for filing the report specified herein for good cause shown.

(2) Attached to the report required by subparagraph (1) of this paragraph shall be an oath or affirmation that to the best knowledge and belief of the individual making such oath or affirmation the information contained in the report is true and correct. The oath or affirmation shall be made before a person duly authorized to administer such oath or affirmation. If the member, broker, or dealer is a sole proprietorship, the oath or affirmation shall be made by the proprietor; if a partnership, by a general partner, or if a corporation, by the chief executive officer,

or in his absence, by the person authorized to act in his place.

(3) For the purposes of this § 240.17a-5(j), "membership interest" shall include the following: Full membership, allied membership, associated membership, floor privileges, and any other interest that entitles a broker or dealer to the exercise of any privilege on an exchange.

(i) For the purposes of this section and § 240.15c3-1(b)(2), any broker or dealer shall be deemed to have ceased to be a member in good standing of such exchange when he or it has resigned, withdrawn, or been suspended or expelled from a membership interest in such exchange or has directly or through any associated person sold or entered into an agreement for the sale of a membership interest which would on consummation thereof result in the termination of the broker or dealer's membership interest in such exchange.

(4) Whenever any national securities exchange whose members are exempt from § 240.15c3-1 by paragraph (b) (2) thereof takes any action which causes any broker or dealer which is a member of such exchange to cease to be a member in good standing of such exchange or when such exchange learns of any action by such member or any other person which causes such broker or dealer to cease to be a member in good standing of such exchange, such exchange shall report such action promptly to the Commission, furnishing information as to the circumstances surrounding the event."